PHILIPPINES ECONOMIC UPDATE: OCTOBER 2019 EDITION

RESUMING PUBLIC INVESTMENT, FAST TRACKING IMPLEMENTATION

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PREFACE

The *Philippines Economic Update* summarizes key economic and social developments, important policy changes, and the evolution of external conditions over the past six months. It also presents findings from recent World Bank analysis, situating them in the context of the country's long-term development trends and assessing their implications for the country's medium-term economic outlook. The update covers issues ranging from macroeconomic management and financial-market dynamics to the complex challenges of poverty reduction and social development. It is intended to serve the needs of a wide audience, including policymakers, business leaders, private firms and investors, and analysts and professionals engaged in the social and economic development of the Philippines.

The Philippines Economic Update is a biannual publication of the World Bank's Macroeconomics, Trade, and Investment Global Practice (MTI), prepared in partnership with the Finance, Competitiveness, & Innovation Global Practice, the Poverty & Equity, Finance, Competitiveness & Innovation, and Social Protection & Labor Global Practices (GPs). Ndiame Diop (Practice Manager for the MTI GP) and Souleymane Coulibaly (Lead Economist and Program Leader) guided the preparation of this edition. The team consisted of Rong Qian (Senior Economist), Kevin Chua (Economist), Kevin Cruz (Research Analyst), Karen Lazaro (Consultant), and Ray Gomez (Consultant) from the MTI GP, Isaku Endo (Senior Financial Sector Specialist) from the Finance, Competitiveness and Innovation GP, Gabriel Demombynes (Program Leader), Xubei Luo (Senior Economist) and Sharon Faye Alariao Piza (Economist) from the Poverty & Equity GP, and Ruth Rodriguez (Social Protection Specialist) and Arianna Zapanta (Consultant) from the Social Protection GP, Roberto Galang (Senior Private Sector Specialist), Graciela Miralles. (Senior Economist) from Investment and Competitiveness, and Karen Lazaro (MT GP) prepared the Special Focus Note on competition. The report was edited by Oscar Parlback (Consultant), and the graphic designer was Christopher Carlos (Consultant). Peer reviewers were Eduardo Olaberria (Senior Economist) and Pedro Miguel Gaspar Martins (Senior Economist). Logistics and publication support were provided by Yvette Camba (Team Assistant). The Manila External Communications Team, consisting of Clarissa David (Senior Communications Officer) and David Llorito (Communications Officer) prepared the media release, dissemination plan, and web-based multimedia presentation, Stephanie Margallo provided team assistance.

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The findings, interpretations, and conclusions expressed in the Philippines Economic Update are those of the World Bank and do not necessarily reflect the views of the World Bank's executive board or any national government.

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ABBREVIATIONS AND ACRONYMS

4Ps	Pantawid Pamilyang Pilipino Program
AfCFTA	African Continental Free Trade Agreement
AFP	Armed Forces of the Philippines
ARMM	Autonomous Region of Muslim Mindanao
ASEAN	Association of Southeast Asian Nations
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
BSP	Bangko Sentral ng Pilipinas
BTE	Barriers to entrepreneurship
BTI	Barriers to trade and investment
BTr	Bureau of Treasury
CAB	Civil Aviation Board
CALABARZON	Cavite, Laguna, Batangas, Rizal, and Quezon provinces.
CIA	Central Intelligence Agency
CIT	Corporate income tax
CITIRA	Corporate Income Tax and Incentives Rationalization Act
CPBI	Census of Philippine Business and Industry
CPI	Consumer Price Index
DBM	Department of Budget and Management
DND	Department of National Defense
DOE	Department of Energy
DOF	Department of Finance
DOH	Department of Health
DOTr	Department of Transportation
DPWH	Department of Public Works and Highways
DTI	Department of Trade and Industry
EAP	East Asia and Pacific
EMBI	Emerging market bond index
EMDEs	Emerging market and developing economies
EPIRA	Electric Power Industry Reform Act
ERC	Energy Regulatory Commission
EU	European Union
FDI	Foreign direct investment
GAB	General Appropriations Bill
GCG	Governance Commission For GOCCs
GDP	Gross Domestic Product
GOCCs	Government-owned and controlled corporations
HHI	Herfindahl–Hirschman Index
I-O	Input-output
IRR	Implementing rules and regulations
IT-BPO	Information technology-business process outsourcing
LE	List of Establishments
LFPR	Labor force participation rate
LGSF	Local Government Support Fund
LGU	Local Government Unit
LLU	Local-loop unbundling
LTFRB	Land Transportation Franchising and Regulatory Board
LTO	Land Transportation Office
MAV	Minimum Access Volume
MCPAT	Market and Competition Policy Assessment Tool
MIMAROPA	Mindoro (Oriental and Occidental), Marinduque, Romblon, and Palawan provinces.
MUP	Military and uniformed personnel
NBQBs	Non-bank financial institutions with quasi-banking functions
NCR	National Capital Region
NEDA	National Economic Development Authority
NG	National Government
NHA	National Housing Authority
NHMFC	National Home Mortgage Finance Corporation
NIA	National Irrigation Administration
NTC	National Telecommunications Commission
OECD	Organisation for Economic Co-operation and Development
PCAB	Philippine Contractors Accreditation Board
PCC	Philippine Competition Commission
PCM	Price-cost margin
PMI	Purchasing Managers' Index
PMR	Product Market Regulation
PPA	Philippine Ports Authority
PSA	Philippine Statistics Authority
RATE	Run after tax evaders
RMR	Regular-milled rice
RRP	Overnight reserve repurchase
RRR	Reserve requirement ratio (RRR)
SC	State control
SEIPI	Semiconductor and Electronics Industry of the Philippines Inc.
SHFC	Social Housing Finance Corporation
SHS	Senior high school
SOCCSKSARGEN	Sarangani, South Cotabato, Sultan Kudarat provinces
SOE	State-owned enterprise
SRP	Suggested retail price
TPA	Third-party access
TRABAHO	Tax Reform for Attracting Better and Higher-quality Opportunities
TRAIN	The Tax Reform for Acceleration and Inclusion Act
TRO	Temporary restraining order
U.S.	United States of America
UCT	Unconditional cash-transfer
WBG	World Bank Group
WMR	Well-milled rice

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EXECUTIVE SUMMARY

Philippine economic growth slowed to its lowest level in eight years, driven by a rapid deceleration in investment growth in the first half of 2019. GDP growth slowed from 6.3 percent year-on-year (yoy) in the first half of 2018 to 5.5 percent in the same period in 2019, below government's growth target of 6-7 percent for 2019. The slowdown was primarily driven by a contraction in nominal public investment due to the delayed passage of the 2019 national government budget and the spending ban on new projects before the May election. Public infrastructure spending shrunk by 15.7 percent yoy in nominal terms, from 5.4 percent of GDP in the first half of 2018 to 4.3 percent of GDP in the same period in 2019. In addition, private investment activities also slowed due to uncertainties around the government's ongoing tax reform program and the external environment.

In this context, private consumption, which regained momentum thanks to declining inflation and improving labor market conditions, was the main driver of growth. Amid declining inflation since the start of 2019, private consumption accelerated from 5.3 percent yoy in the second half of 2018 to 5.8 percent in the first half of 2019, contributing nearly three fourths to economic growth. The recovery in private consumption was also supported by the continued improvement in labor market conditions in 2019, steady flows of remittances and continued expansion of credit. The unemployment rate reached its lowest level in over a decade in April 2019 and job quality improved as underemployment rate also fell to its lowest in over a decade. Job creation exceeded the Government target despite the budget delay thanks to robust job creation in the non-construction services sectors.

Export activities decelerated significantly amid escalating trade tensions and weakness in global economic activity. Philippine exports slowed to its weakest growth rate since 2013 in both merchandise and service exports. The substantial slowdown in merchandise exports was driven in large part by the continued slowdown in electronic exports, likely influenced by the U.S.-China trade war, while non-electronic exports growth also moderated owing to the softening in global trade, manufacturing, and investment activities. The weakness in services export growth reflected slower growth in the information technology business process outsourcing industry. In response to the weaker pace of investment and weak manufacturing output, import growth registered a sharp deceleration in the first half of 2019, reflecting a substantial slowdown in capital goods imports and a contraction of imports of raw material and intermediate goods.

The fiscal deficit narrowed due to robust revenue collection and delays in public spending. The national government incurred a fiscal deficit of 0.5 percent of GDP in the first half of 2019, significantly smaller compared to 2.3 percent in the same period in 2018. Despite slower GDP growth, revenue collection remained robust thanks to the second round of increases in excise taxes rates under the Tax Reform for Acceleration and Inclusion (TRAIN) law and tax administration improvements. At the same time, the delay in the approval of the 2019 national budget coupled with the spending ban prior to the May election led to underspending across all spending categories. Although public spending is expected to accelerate in the second half of the year, for the whole 2019, the fiscal deficit is likely to hover below the Government target of 3.2 percent of GDP.

Amid weak fiscal spending and declining inflation, the *Bangko Sentral ng Pilipinas* (BSP) adopted a more accommodative monetary policy stance in the first half of 2019. Inflation declined steadily so far in 2019, returning to the BSP's 2-4 percent target, thanks to stabilizing food and energy prices. In particular, the domestic price of rice registered only a small increase in the first half of 2019, despite a reduction in the local production, due to an influx of private rice imports. Energy prices were lower, driven by lower international crude oil prices and downward adjustment of local electricity prices. Falling price pressures prompted the BSP to reduce key policy rate by 25 basis points in May and another 25 basis points in August 2019 to reach 4.25 percent, a gradual reversal from the 175 basis points increase since May

2018. In addition, to further expand domestic liquidity and boost credit growth, the BSP reduced the reserve requirement ratio by 200 basis points incrementally.

Improvements in external financing conditions led to portfolio inflows in the Philippines, contributing to the appreciation of the Philippine peso and rebuilding of its foreign reserves. The more dovish stance of the U.S. Federal Reserve since the start of the year contributed to an inflow of capital to the emerging economies. As one of the fast-growing economies with strong macroeconomic fundamentals, the Philippines benefitted from the global capital flow through the local stock market and long-term borrowing by the national government. Although FDI contracted, portfolio inflow more than compensate the current account deficit resulting in the balance of payment turning into a surplus in the first half of 2019, reversing the deficit recorded in the same period in 2018. Moreover, the Philippine peso appreciated in the first seven months of 2019 as a result of the increasing capital inflows, leading to an increase of foreign reserves to cover 7.4 months' worth of imports and payment of services and primary income in June 2019, from 7.1 months' worth in June 2018.

The Philippines' growth outlook is weakened given the unfavorable external environment and domestic challenges. The World Bank revised down the country's economic growth for 2019 from 6.4 percent to 5.8 percent, before recovering to 6.1 percent in 2020 and 6.2 percent in 2021. The downward revision considers the expected slower investment growth for 2019 relative to 2018 given the weak performance of the first half of 2019, and gradual recovery in the pace of public spending in the second half of 2019. Given weak external environment, net exports will remain subdued throughout the rest of 2019. In the medium term, as global growth moderately recovers while the government resumes its expansionary fiscal policy by accelerating infrastructure spending, economic growth is expected to surpass 6.0 percent in 2020-21. This assumes, however, the timely passage of 2020 national budget and resolution of uncertainties around the passage of the Corporate Income Tax and Incentives Rationalization (CITIRA) bill.

Despite a temporary slowdown in economic growth in the first half of 2019, progress on poverty reduction and shared prosperity is likely to continue. Given the continuous expansion of non-agricultural wage employment, the recent rising real wage, continuation of social programs, and stabilizing inflation, the declining trend in poverty is likely to continue in 2019-21. Moreover, preliminary estimates showed that household incomes of the poor grew at a much faster pace than the average household. The continued expansion of non-agriculture wage and salary employment together with the recent institutionalization of the *Pantawid Pamilyang Pilipino Program* (4Ps) will help to sustain progress on shared prosperity in 2019-21.

External risks have intensified which could be exacerbated by a slow recovery in domestic investment growth. The Philippines faces heightened external risks due to the slowdown in global growth and demand as well as rising global protectionism. In addition, the prolonged unresolved trade dispute between the U.S. and China strains the regional value chain that the Philippines is part of. On the domestic front, a slow pick up in the pace of public spending and limited absorptive capacity and procurement difficulties, pose downside risks to the baseline forecast. As such, ensuring the timely passage of the 2020 budget will be critical to continue the public investment momentum in the medium term.

In the short term, fast tracking the implementation of recently approved game-changing reforms would help to achieve inclusive growth. As part of the 10-point socioeconomic agenda of the government, various game changing reforms have been passed in 2018 such as the Ease of Doing Business Law, the rice tariffication law, the creation of a foundational ID, the national payment system act, and the move towards cash-based budgeting, among others. These are transformational policy changes that have the potential to accelerate inclusive growth. Given the heightened external risks, fast tracking the implementation of these reform will not only protect market confidence in the government's development agenda, but more importantly boost private investment to sustain and accelerate inclusive growth.

Furthermore, continued prudence in managing fiscal and current account balances is needed to preserve business confidence. Fiscal and current account deficits are expected to widen as the government resumes the fast pace of public investment growth to address country's infrastructure gap and stimulate the economy amid weak global demand. To preserve business confidence, the twin deficits need to be managed carefully. The swift passage of remaining tax reforms will help preserve fiscal sustainability and prevent crowding out of private investment. Moreover, as electronics exports are expected to continue facing the headwinds brought about by the trade war, diversifying the country's export market through boosting non-electronics exports sales will be crucial in financing growing imports needs.

In the long term, promoting competition to foster quality job creation will enhance the impact of economic growth on poverty reduction and shared prosperity. Philippine markets, including those with low natural entry barriers, are highly concentrated, suggesting a lack of competition in many sectors. More specifically, markets in manufacturing, wholesale/retail, agriculture, and transport/storage that are usually prone to open competition, appear to be highly concentrated, suggesting that market rules and regulations and the behavior of dominant players hinder competition. According to Product Market Regulation (PMR) indicators, markets are more restrictive in the Philippines than comparator countries, with a heavier weight on restrictions related to state control, barriers to entrepreneurship, and barriers to trade and investment. This has translated into relatively poor service delivery and higher prices for goods and services paid by households and firms compared to other countries, particularly in key sectors such as telecommunications, transportation and logistics, and power. Clearly, reducing regulatory restrictions in key markets would significantly support firms' competitiveness and household welfare in the Philippines as argued in Part III of this report.

Implementing a set of reforms will be critical in reducing regulatory restrictiveness in key markets. First, tackling unclear or restrictive regulations in infrastructure sectors and professional services to create more competitive conditions would have positive effects on downstream markets. Second, eliminating restrictions on foreign as well as domestic investors could help level the playing field. Third, minimizing the scope of controlled prices would incentivize firms to compete. Fourth, lessening the involvement of the state through state-owned enterprises (SOEs) and other operations in typically competitive markets and ensuring competitive neutrality among public and private operators would promote a more effective use of public funds. Finally, streamlining burdensome administrative procedures for businesses could facilitate easy market entry.

01

RECENT DEVELOPMENTS

SLOWING GROWTH MOMENTUM AMID EXTERNAL AND DOMESTIC CHALLENGES

Economic growth slowed to 5.5 percent, year-on-year (yoy), in the first half of 2019, as investment activity moderated significantly. Private consumption growth rebounded and was the economy's main growth driver, supported by improving conditions for robust private domestic demand – such as lower inflation.

In the first half of 2019, economic growth slowed to its slowest level in eight years amid a challenging external environment and a slowdown in investment growth. Philippine economic growth decelerated from 6.3 percent, yoy, in the first six months of 2018 to 5.5 percent in the same period in 2019—below the government's growth target of 6-7 percent for 2019. The poor growth performance was primarily driven by the substantial slowdown in fixed investment growth, expanding at its slowest pace since 2011, as public investment was tempered by the reenactment of the 2019 national government budget for the first four months of the year and spending ban for new projects before May election. Private investment activities also slowed due to uncertainties around the government's ongoing tax-reform program and the external environment. External demand remained weak, as the country's net-exports performed poorly amid slow global growth and uncertainties in the global trade policy environment. Private consumption was the main growth driver (Figure 1), supported by a significant moderation in inflation, a healthy labor market, boost from pre-election spending activities,[1] and steady growth in remittances,[2] albeit dampened by worsening consumer confidence in the first two quarters of the year. Meanwhile, public consumption growth slowed compared to the previous year, as the reenacted budget,[3] which was in effect for most of the first half of 2019, caused significant delay in the implementation of new programs and projects, including the implementation of the fourth tranche of the government's salary standardization law.[4]

Private consumption recovered in the first half of 2019, amid a more supportive environment from robust domestic demand. Amid declining inflation since the start of 2019, private consumption accelerated from 5.3 percent, yoy, in the second half of 2018 to 5.8 percent in the first half of 2019, contributing nearly three fourths to economic growth. Sustained growth in private household demand was the result of a combination of factors that created a robust environment for improved domestic demand. In particular, inflation, which contributed negatively to consumption growth particularly during the second half of 2018, moderated to 3.4 percent, yoy, in the first half of 2019, much lower than the 4.3 percent recorded in the same period a year ago and within the BSP's 2-4 percent inflation target. Private consumption was further bolstered by the steady growth in

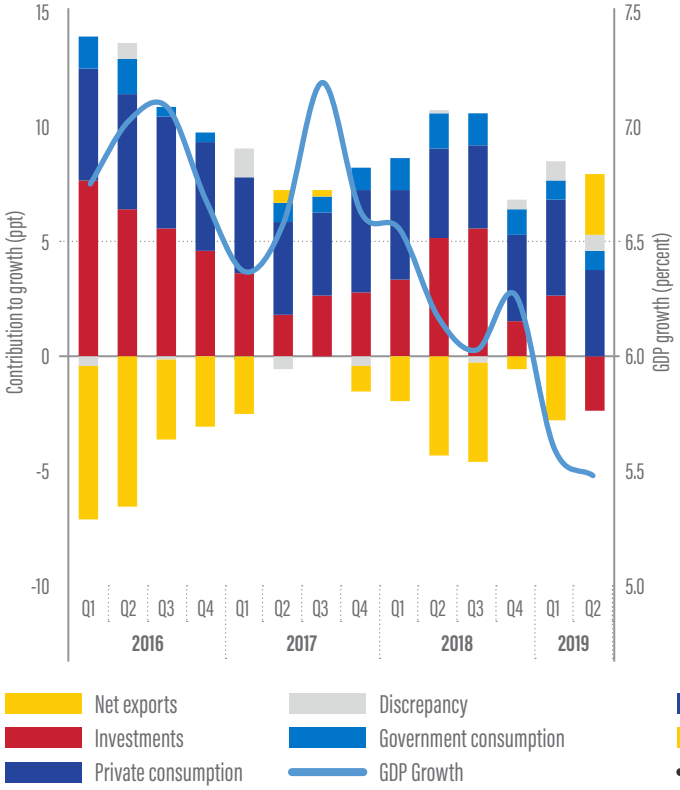
1 The May 2013 Philippine Economic Update details the transmission mechanisms by which election related activities spill over into improved domestic activity. The increased domestic activity during an election year may result in an increase in growth of up to 2.0 percentage points in the first half of the year due to election related spending, which significantly bolsters domestic activity in fixed investment, particularly on construction, and the services sector, which benefit from higher employment. These in turn result in improved employment during this period, which translates into potentially higher consumption spending. Source: https://www.worldbank.org/content/dam/Worldbank/document/EAP/Philippines/Philippine_Economic_Update_May2013.pdf

2 Cash remittances from overseas Filipinos grew by 4.5 percent, yoy, during the first five months of 2019, consistent with historical averages.

3 The 2019 national government budget was signed into law on April 15, 2019, after a more than four-month long delay due to an impasse between both houses of Congress. The delayed passage resulted in the national government operating under thethe 2018 budget (reenacted budget) for the first four months of 2019. This resulted in the delayed implementation of new programs and projects under the 2019 budget, as no new programs and projects would receive funding under a reenacted budget.

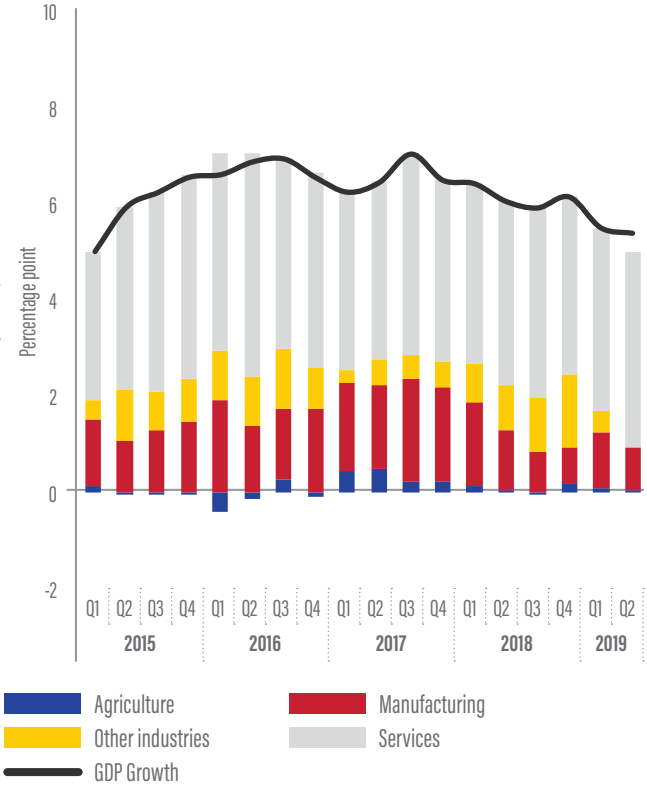
4 This is the fourth in a series of adjustment to public wages based on Executive Order No. 201, series of 2016 which modifies the salary schedule for civilian government personnel and authorizing the grant of additional benefits to both civilian and military and uniformed personnel. The public wage and benefits adjustments began in 2016, and were adjusted each year thereafter until 2019, the fourth and final tranche of the salary adjustment.

Figure 1.
Private consumption fueled yoy growth in the first half of 2019, as investment spending and net-exports weakened...



Source: Philippines Statistics Authority (PSA).

Figure 2.
...while services remained the main engine of growth on the production side.



Note: Other industries are mining and quarrying, construction, electricity, gas, and water.

Source: PSA.

remittances from overseas Filipinos,[5] the continued expansion of credit, an improving job market,[6] and an increase in economic activity from election-related spending.

Fixed capital investment growth was sluggish in the first six months of 2019, weakened by a contraction in public investment spending and moderation in private investment growth. Fixed investment growth softened to its lowest level since 2011, fueled by an abrupt slowdown in the growth of construction investments,[7] and a contraction in durable equipment investment growth. Construction investment growth decelerated from 11.5 percent, yoy, in the first half of 2018 to 4.2 percent in the same period in 2019, as public construction investment growth contracted by 22.1 percent, yoy, in the first half of 2019—a sharp reversal from the 21.4 percent growth recorded a year ago. The significant decline in public construction investments was primarily the result of the stalled implementation of the national government's sizable infrastructure outlay program due to the delayed budget approval. Meanwhile, investments in durable equipment declined by 2.9 percent, yoy, in the first half of 2019, after expanding by double-digits in the past four years. The contraction was driven by fewer investments in specialized machinery and transport equipment, accounting for around two-thirds of total durable investments, as manufacturing activity and exports slumped in the first half of 2019 due to weakness in external demand. In addition, policy uncertainty around the government's proposed corporate tax-reform package has dampened investment growth in the private sector.

5 Cash remittances expanded by 4.5 percent yoy in the first five months of 2019 compared to 4.2 percent a year ago, to reach US$12.3 billion.

6 Labor market conditions improved until April, latest data available.

7 Fixed capital investment growth fell from 13.5 percent, yoy, in the first half of 2018 to 0.8 percent in the same period in 2019—the slowest rate since the second half of 2011 (-2.1 percent).

Export activities significantly decelerated during the first half of 2019, reflecting softer external demand amid weakness in global economic activity (Box 1). Philippine export growth slowed to its weakest level since 2013, growing by 5.0 percent, yoy, in the first half of 2019, less than half of the 12.6 percent registered a year ago, as the growth in both merchandise and services exports decelerated to single-digits. The substantial slowdown in merchandise exports was driven in large part by the continued slowdown in electronics exports,[8] as semiconductor exports registered a sharp growth deceleration,[9] likely due to sluggish demand for smartphone parts and the impact of the U.S.-China trade war (Box 2).[10] Likewise, exports of other major commodity groups also registered a significant slowdown in growth, owing to the softening in global trade, manufacturing, and investment activities (Figure 3 and Figure 4). This was partly due to higher tariffs between China and the U.S., which weighed on regional trade. Meanwhile, import growth sharply decelerated to 4.2 percent, in the first half of 2019 from 16.1 percent a year ago, driven by the substantial slowdown in the growth of capital goods due to the slower pace of investment spending. In addition, the import of raw materials and intermediate goods also contracted as the country's manufacturing industry continued to struggle. As trade tensions among major economies intensify, policymakers need to find ways to shelter the domestic economy to preserve the poverty reduction gains from the steady growth of the past decade. Fostering competition in key backbone services would be a first start (cf. Part III of this report).

On the production side, services fueled growth in the first half of 2019, while the agriculture sector barely grew for the second consecutive year. The services sector grew by 7.0 percent, yoy, in the first six months of 2019, up from 6.7 percent in the same period in 2018 (Figure 2). The uptick in growth was led by faster growth in finance, wholesale and retail trade, and the transport, communication, and storage subsectors, which benefitted from improved private domestic demand. Meanwhile, the country's agriculture sector barely grew for the second consecutive year, as the crops subsector contracted by 2.1 percent, yoy, in the first six months of 2019, compared to a mere 0.4 percent contraction a year ago. The poor performance of the crops subsector was due to a substantial decline in both palay and corn production,[11,12] which was in large part the result of the widespread drought that impacted several regions in the Philippines because of El Niño.[13] The country's agriculture sector remains vulnerable to weather-related phenomenon due to the absence of adequate support infrastructure and services such as a well-developed irrigation system.

8 Electronics exports accounted for nearly half of the country's total merchandise exports, and its growth decelerated from 15.8 percent, year-on-year, in the first half of 2018 to 5.3 percent in the same period in 2019.

9 Semiconductor exports, which account for 30 percent of total goods exports, expanded by 4.7 percent, year-on-year, in the first half of 2019, down from 13.5 percent a year ago.

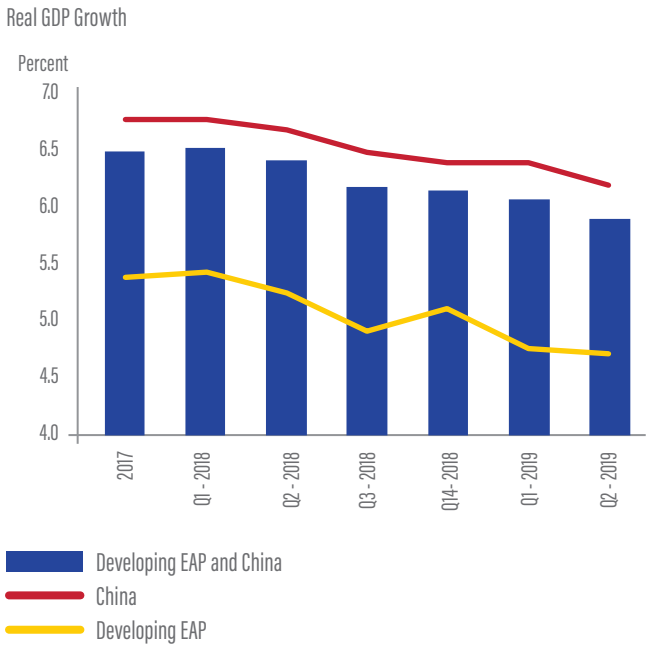
10 The Semiconductor and Electronics Industry of the Philippines Inc. (SEIPI) predict flat growth for semiconductors in 2019 due in large part to the "heavy decline in demand for smart phones" and the likely effect of an "extended trade war." Source: https://business.mb.com.ph/2019/05/15/electronics-sector-lowers-2019-export-growth-target/

11 Palay and corn contracted by 4.5 percent year-on-year and 2.1 percent, respectively, and accounted for around 52 percent of total crop output in the first half of 2019.

12 In addition, notable crops such as banana, coffee, cassava, sugarcane, and coconut registered a decline in output in the first half of the year.

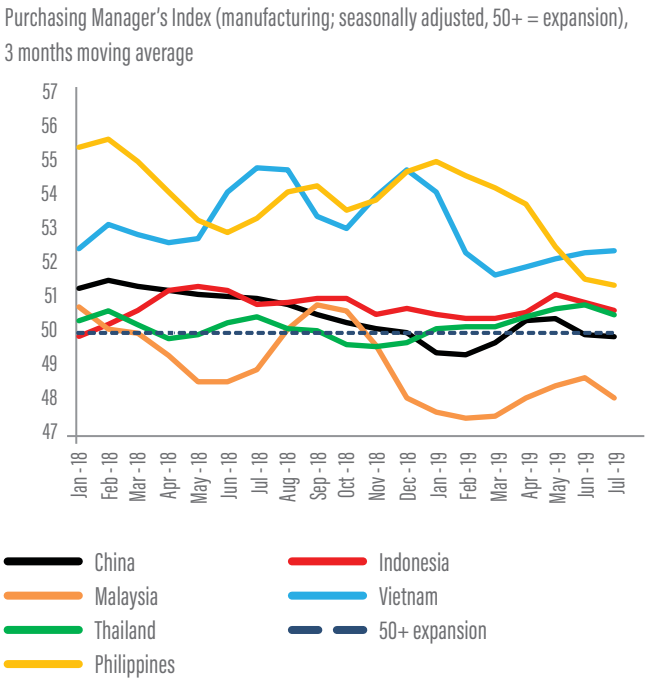
13 In the first quarter of 2019, the total value of crop damage reached Php4.4 billion (https://www.rappler.com/business/230020-farm-output-growth-q1-2019), as the dry spell impacted farm output in Cagayan Valley, CALABARZON, MIMAROPA, Western Visayas, Central Visayas, Zamboanga Peninsula, Northern Mindanao, and SOCCSKSARGEN. Source: 2019. Philippine Statistics Authority. Performance of Philippine Agriculture.

Figure 3.
Growth in developing East Asia Pacific (EAP) and China moderated in the first quarter of 2019...



Source: Haver Analytics; World Development Indicators; World Bank Staff calculations.

Figure 4.
...and manufacturing activity softened in line with the slowdown in global demand.



Source: Haver Analytics; World Bank Staff calculations.

The industry sector grew at its slowest pace in nearly eight years, as both the manufacturing and construction sectors struggled in the first half of 2019. Industry sector growth decelerated from 7.1 percent, yoy, in the first six months of 2018 to 4.2 percent in the same period in 2019—the slowest rate since the second half of 2011 (1.4 percent). Weaker growth was driven by a slowdown in manufacturing and construction output, which make up nearly 90 percent of total industrial output. Manufacturing growth decelerated from 6.5 percent, yoy, in the first half of 2018 to 4.4 percent in the same period in 2019, despite robust growth in food manufactures, which accounted for more than half of all manufacturing output.[14] The slowdown in growth was led by the steep decline in the growth of radio, television, and communication equipment apparatus (which includes electronics production) manufactures, in line with the tepid performance of the country's electronics exports in the first half of the year.[15] Growth in most other manufacturing subsectors also slowed as external demand softened[16] and investment activity weakened in the first half of 2019.[17] Growth in the construction sector, after four consecutive quarters of double-digit growth, fell from 11.6 percent, yoy, in the first six months of 2018 to 3.9 percent in the same period in 2019, as public construction spending contracted due to the delayed passage of the national budget.

14 Growth in food manufactures expanded by 8.6 percent, year-on-year, in the first half of 2019, up from an average of 6.3 percent a year ago, benefitting from healthy domestic demand and private consumption.

15 Manufactures of radio, television, and communication equipment apparatus, which account for around 15 percent of total manufacturing output, contracted by 0.3 percent, year-on-year, in the first half of 2019, a steep decline from 13.5 percent growth registered a year ago.

16 Exports of manufactured goods contracted by 1.5 percent, year-on-year, in the first half of 2019, led by a 12.9 percent decline in machinery and transport equipment. Moreover, electronic products, which account for two-thirds of the country's manufactured goods exports, registered nearly flat growth as the country's semiconductors exports slowed in the first half of 2019.

17 Sectors that experienced a slowdown in growth include petroleum, rubber, and plastic products; machinery and equipment (except electrical); office, accounting, and computer machinery; transport equipment; and furniture and fixtures.

Table 1.
Contribution to Growth, Expenditure Side (Percentage Points)

	2016 H1	2017 H1	2018 H1	2019 H1
Private Consumption	**5.0**	**4.1**	**4.0**	**3.9**
Government Consumption	**1.5**	**0.4**	**1.4**	**0.9**
Capital Formation	**7.0**	**2.7**	**4.2**	**0.0**
Fixed Capital Formation	**6.8**	**2.7**	**3.8**	**0.2**
Construction	1.3	0.6	1.1	0.4
Durable Equipment	5.2	1.7	2.5	-0.5
Net Exports	**-6.7**	**-0.9**	**-3.3**	**0.0**
Exports	**5.7**	**10.0**	**7.3**	**3.1**
Merchandise Exports	3.7	8.8	5.6	2.5
Services Exports	2.0	1.1	1.6	0.5
Imports	**-12.3**	**-10.9**	**-10.5**	**-3.0**
Merchandise Imports	-11.2	-10.1	-9.4	-2.5
Services Imports	-1.1	-0.8	-1.1	-0.5
Gross Domestic Product	**6.9**	**6.5**	**6.3**	**5.5**

Source: PSA.

Table 2.
Contribution to Growth, Supply Side (Percentage Points)

	2016 H1	2017 H1	2018 H1	2019 H1
Agriculture, Fishery, & Forestry	**-0.3**	**0.5**	**0.1**	**0.1**
Agriculture & Forestry	-0.2	0.5	0.1	0.0
Fishery	-0.1	0.0	0.0	0.0
Industry	**2.7**	**2.2**	**2.4**	**1.5**
Mining & Quarrying	0.0	0.0	0.0	0.1
Manufacturing	1.6	1.8	1.5	1.0
Construction	0.7	0.3	0.7	0.1
Electricity, Gas, & Water	0.3	0.1	0.2	0.2
Services	**4.5**	**3.8**	**3.9**	**4.0**
Transport, Communication, & Storage	0.5	0.3	0.5	0.5
Trade	1.3	1.0	1.0	1.2
Finance	0.6	0.6	0.6	0.7
Real Estate, Renting and Business Activities	1.0	0.9	0.5	0.4
Government Services	0.2	0.3	0.6	0.4
Other Services	0.9	0.7	0.8	0.7
Gross Domestic Product	**6.9**	**6.5**	**6.3**	**5.5**

Source: PSA.

Box 1.
Recent Global Developments

Weaker investment growth and declining trade and manufacturing activity contributed to continued subdued global growth in the first half of 2019 (Figure 5). The global real GDP growth rate was estimated at 2.6 percent in 2019—lower than the 3.0 percent recorded in 2018 and a downgrade of 0.3 percentage points from the growth forecast in January 2019. Incoming data even suggest that global activity will remain subdued going into the third quarter of 2019. Renewed trade tensions involving major economies have triggered a rise in policy uncertainty, dampening business confidence and investment growth (Figure 6). Due to a dimmer economic outlook and below target inflation in advanced economies, key central banks have signaled a more accommodative monetary policy, easing global financing conditions and increasing capital flows to emerging market and developing economies (EMDEs). However, this has not been enough to outweigh the effect of weaker global demand on EMDEs' export performance, resulting in slower growth in many EMDEs.

Activity in major economies decelerated to 2.1 percent in Q2 2019 but remained resilient. The U.S. economy has been expanding for 121 months, the longest period of uninterrupted growth on record. In light of muted inflation and rising risks from the external environment, the Federal Reserve lowered the target range for the federal funds rate to 2-2.25 percent in July, the first rate cut since the 2008 financial crisis. In the euro area, economic conditions have remained weak, driven by moderating manufacturing and industrial activity amid sharply declining exports. The subpar growth performance, along with easing inflation and lingering downside risks, has prompted major European countries to facilitate fiscal and monetary policy support.[18] In Japan, consumer confidence has dropped in recent months to its lowest level since 2014 while inflation excluding fresh food and energy remains low—it stood at 0.3 percent in May, unchanged since the beginning of the year. Japan's economic activity has likewise been dampened by weak external demand and will likely soften further due to a recent hike in the country's value-added tax.[19] Recent data suggest that the U.K. economy has been fragile in Q2 2019 amid uncertainty over Brexit and as retail sales dipped in both April and May, and both the manufacturing PMI and economic sentiment fell to their lowest readings since 2013.

Economic growth in EMDEs softened in the beginning of 2019, influenced by weaker external demand and investment amid continued global trade policy uncertainties. Investment growth is expected to continue to soften in EMDEs, which will slow the growth of imports (Figure 7). EMDEs under pressure[20] are especially vulnerable, including many commodity exporters such as Argentina and Iran that have recently suffered severe financial market stress and economic sanctions. Moreover, the economies of some large commodity exporters have had slow recoveries due to global oil production cuts, magnified by domestic policy uncertainties. In other EMDEs, including commodity importers, economic growth has been impeded by capacity constraints and softer external demand. Subdued growth in EMDEs has also been due to lackluster investment spending, which has been held back by sluggish global growth, limited fiscal space, and structural constraints that misallocate or discourage investment, such as a poor business environment, labor and product market controls, and weak governance. Slower economic activity in some European EMDEs was attributed to close ties with the euro area, which has suffered slower-than-expected growth, as well as ongoing domestic challenges and financial headwinds. While several Asian EMDEs, including the Philippines, have demonstrated robust growth, averaging 6-7 percent, their growth momentum is waning. Meanwhile, China's economic growth decelerated to 6.2 percent yoy in Q2 2019 amid its weak manufacturing sector, trade dispute with the U.S., and the global growth slowdown continue to hamper its foreign trade.

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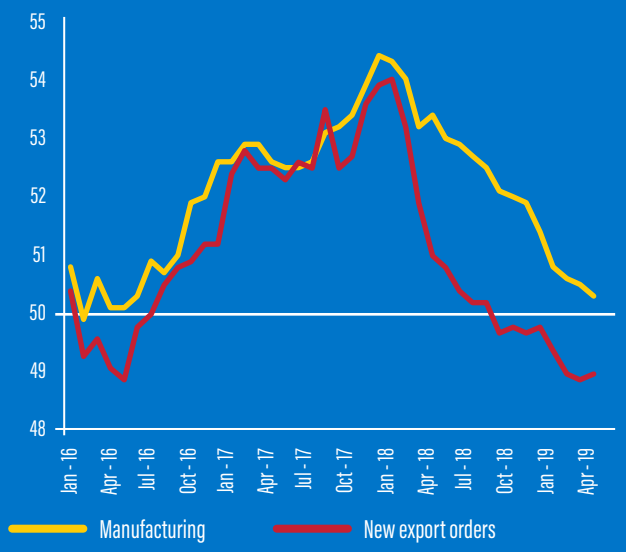
18 Germany, France, and Italy have announced plans for limited tax cuts and spending increases, equivalent to a combined 0.2 percent of euro area GDP per year during 2019-21. In addition, the European Central Bank has announced it will provide banks with additional low-cost credit, starting in September. *Source: World Bank, Global Economic Prospects, June 2019 and Global Monthly (July 2019).*.

19 A value-added tax hike in October is likely to further dampen economic growth. *Source: World Bank, Global Economic Prospects, June 2019, and Global Monthly (July 2019).*

20 EMDEs under recent pressure include: a) countries that have had an increase in their J.P. Morgan EMBI credit spread of at least one standard deviation above the 2010-19 average at any time since April 2018 (Argentina, Brazil, Egypt, Gabon, Jordan, Lebanon, Mexico, Nigeria, South Africa, Sri Lanka, Tunisia, Turkey); or b) countries that have been subject to recent sanctions (Iran, Russia). *Source: World Bank, Global Economic Prospects, June 2019 and Global Monthly (July 2019).*

Worsening trade policy uncertainty (Figure 8) and slowing investment growth have contributed to the slowdown in global trade. Along with slowing investment growth, a series of protectionist and retaliatory trade measures between major economies such as the U.S., China, and other major trading partners (Box 2) have partly disrupted normal trade flows, as the growth in traded goods and new export orders fell considerably in the beginning of 2019. Tensions have also escalated elsewhere, such as between Japan and South Korea. The ratification of MERCOSUR countries (Argentina, Brazil, Paraguay, and Uruguay) may also be delayed by policy disagreements. Moreover, amid heightened trade policy uncertainty, the demand for heavily traded capital goods in global value chains has declined, resulting in slower industrial growth. Worse outcomes are likely to be observed if trade tensions further escalate. Despite growing protectionism, recently-concluded trade agreements (e.g. AfCFTA, EU-Vietnam) could help boost trade and foster regional integration among signatory countries.

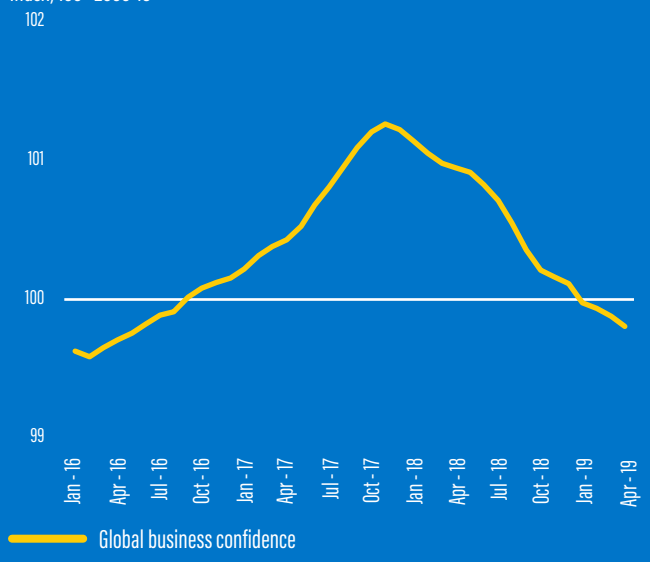
Figure 5.
Global manufacturing and trade growth continued to decelerate in early 2019.
Index, 50+=expansion



Source: Global Economic Prospects, June 2019.

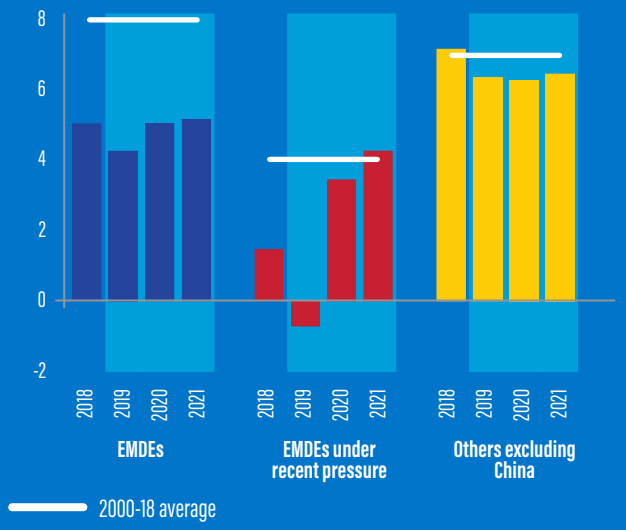
Figure 6.
Business confidence has worsened amid renewed trade tensions.

Index, 100=2000-18



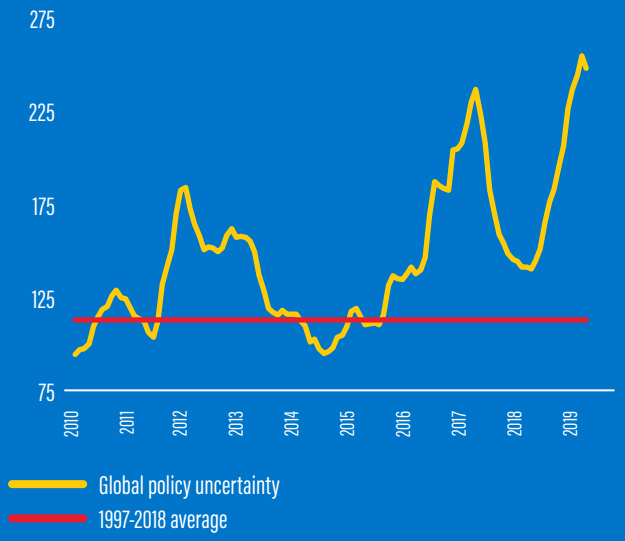
Source: Global Economic Prospects, June 2019.

Figure 7.
Investment growth in EMDEs has remained sluggish.
Percent



Source: Global Economic Prospects, June 2019.

Figure 8.
Global policy uncertainties have persisted.
Index, 6-month moving average



Source: Global Economic Prospects, June 2019.

Box 2.
The Impact of Softening Global Trade and Escalating Trade War on Philippine Foreign Trade

The Philippines' export performance has mirrored the decline in global trade growth since 2018, worsened by uncertainties surrounding trade tensions between major economies. Heightened policy uncertainty from the ongoing trade war between the U.S. and China has undermined business confidence and investment and contributed to the slowdown in global trade (Figure 9). Furthermore, the tariffs implemented by the U.S. and China against each other in 2018 affected 2.0 percent of world merchandise trade in 2018, or more than half of the 3.8 percent of world merchandise trade affected by tariffs. However, available data show a limited impact on each country's aggregate trade volumes and prices of targeted commodities.[21,22] As of June 2019, the global trade growth projection for 2019 has been downgraded to 2.6 percent, a considerable reduction from the 4.1 percent growth posted in 2018. Softening capital goods trade, including electronic components such as semiconductors that are tightly linked with global production chains, has particularly contributed to the widespread deceleration in global trade growth.[23] Global trade dynamics have been mirrored in the Philippines: the country's goods trade growth decelerated from 5.4 percent, yoy, in January 2018 to 0.4 percent in April 2019, with negative growth rates recorded twice in 2019. Meanwhile, there was a contraction in new export orders in Q4 2018 through Q1 2019.

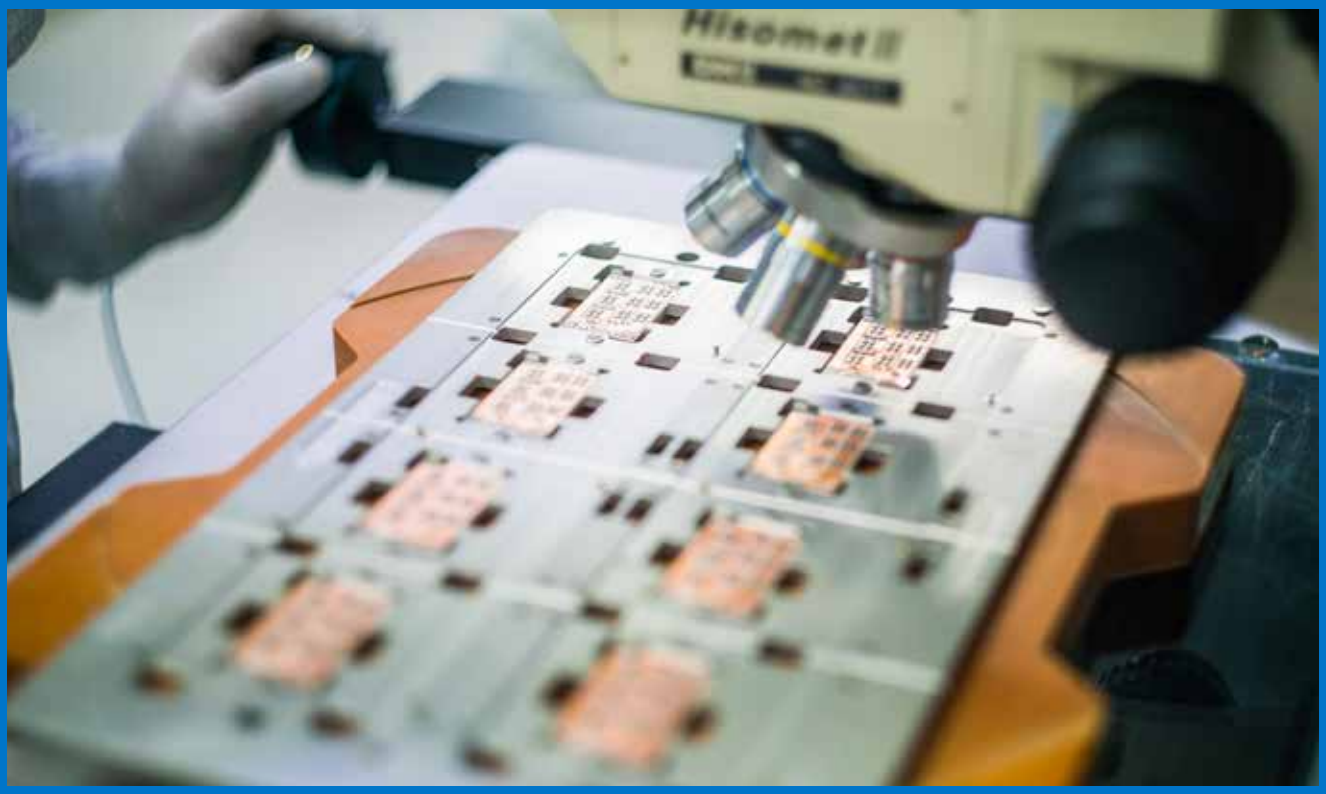
Despite agreeing to restart trade talks two months prior, the U.S-China trade conflict escalated in August 2019 as the U.S. threatened to impose tariffs on the remaining untaxed Chinese products which partially took effect in September 2019. Since July 2018, a series of protectionist policies and retaliatory responses between the U.S. and China resulted in US$550 billion worth of Chinese products imposed with U.S. tariffs, and a total of US$185 billion worth of U.S. goods exclusively taxed with Chinese tariffs. Following a brief truce before meeting at the G20 Summit in Japan in June 2019, the two countries agreed to restart trade discussions, suggesting a pause in the extended tariff exchanges. Amid the renewed trade dialogue, the U.S. relaxed restrictions on Huawei, a Chinese telecom giant, to purchase from American tech companies as China agreed to procure more farm goods from the U.S. Nonetheless, doubts persisted because no timeline was agreed upon regarding the trade deals, and recently imposed tariffs remained in place. In August 2019, uncertainties intensified as the trade dispute deepened due to the U.S. threat to impose 10 percent tariffs on the remaining un-levied Chinese imports worth over US$300 billion, which partially took effect in September 2019 on the US$125 billion Chinese imports, and the rest is due to hit in December 2019. In retaliation, China imposed additional US$75 billion tariffs on U.S goods. The first batch of U.S. goods will be taxed at 5 percent effective September 2019 and the second at 10 percent in December 2019. China also earlier responded by allowing its currency, the yuan, to depreciate to mitigate, if not to offset the impact of the higher cost of trading with U.S., which led the latter to designate China as a currency manipulator.

Furthermore, looming trade tensions between the U.S. and other major trading partners are expected to weigh on already weakening global demand. On July 1, 2019, the U.S. threatened to impose new tariffs on US$4 billion worth of European products, in addition to the US$21 billion worth of goods announced in April 2019, over European subsidies to aircraft manufacturers. Moreover, India's eligibility for preferential market access to the U.S. was removed in early June 2019 because of alleged local market restrictiveness against U.S. firms, resulting in import levies on US$6 billion worth of Indian products exported to the U.S. In retaliation, India imposed higher tariffs on twenty-eight U.S. products. France's plans to impose a digital-services tax of 3 percent on technology firms, including large U.S. companies like Amazon, Apple, Google, and Facebook, has also prompted the U.S. to threaten protectionist policies similar to the tariffs against Chinese and European products. Meanwhile, bilateral tensions are escalating in East Asia, as Japan and South Korea have also resorted to protectionist trade measures as relations turned sour after the South Korean Supreme Court challenged a 1965 diplomatic treaty that considered all reparations for offensive acts committed during the Japanese occupation of the Korean Peninsula six decades ago complete and final.

21 Constantinescu, I., A. Mattoo, and M. Ruta. 2019. *Trade Amid Tensions. Global Trade Watch 2018*. Washington, DC: World Bank Group. and Fajgelbaum, P. D., P. K. Goldberg, P. J. Kennedy, and A. K. Khandelwal. 2019. "The Return to Protectionism." NBER Working Paper 25638, National Bureau of Economic Research, Cambridge, MA.

22 World Bank, Global Economic Prospects, June 2019.

23 The slowdown in international trade has been widespread, as countries with industrial production suffering from technical recession reached 25 percent in early 2019, up from less than 9 percent in 2018.



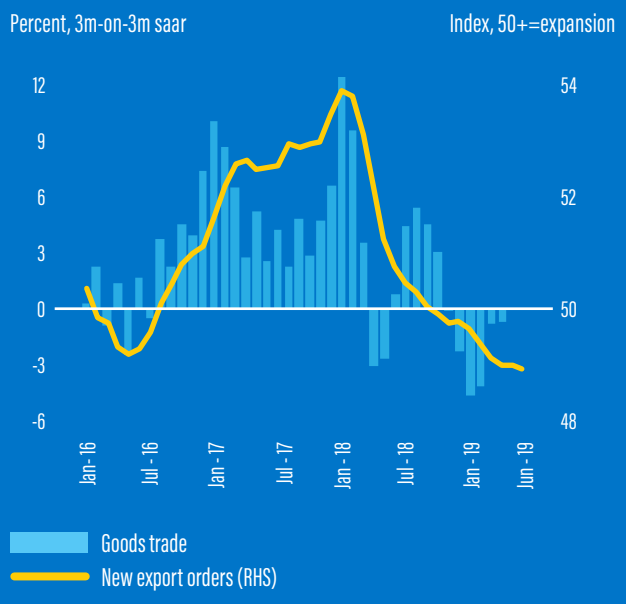
The impact of the ensuing import substitution on Philippine foreign trade appears to have so far been modest. Given the ongoing U.S-China trade dispute, U.S. imports of Chinese goods declined by 12.4 percent between January and June 2019, reversing the 8.8 percent growth posted over the same period in 2017-18. Imported U.S. goods in China also contracted by 29.9 percent between January and June 2019. As the cost of importing goods between the U.S. and China increases due to the newly imposed tariffs, neighboring countries are expected to benefit as the two major economies look for cheaper substitutes. However, because of few similarities between the Philippine export basket and Chinese products affected by U.S. tariffs,[24] trade diversion seemed to have had a modest impact on Philippine foreign trade. Yet, Philippine exports to the U.S. expanded by 10.3 percent in January-June 2019, faster than the 9.4 percent growth recorded during the same period in 2018, indicating that the Philippines has partly absorbed U.S. imports of easily substitutable electronic goods like hard-disk-drive units (Figure 10).[25] However, the Philippines' U.S. export growth performed poorly compared to that of Vietnam, which grew by 27 percent in January-June 2019, three times the growth registered in 2018.

Supply-chain shifts accelerated by the U.S.-China trade war may have weighed on Philippine exports. Before the trade dispute, several export manufacturers based in China had considered relocating to other countries, mainly due to rising labor costs. However, these plans may have been fast-tracked to avoid U.S. tariffs. It was expected that reduction in U.S. imports of Chinese products could adversely affect EAP countries linked to the Chinese-led production-chain, including the Philippines. Although Philippine exports to China grew by 9.2 percent, yoy, in the first half of 2019, it was notably slower than the 66.5 percent and 14.6 percent growth rates logged in the first half of 2017 and 2018, respectively (Figure 10). The Philippines' export basket to China largely contains intermediate goods such as electronic products, and China remains one of the Philippines' major trading partners. Nevertheless, the electronics downcycling, the overall easing of China's economy, and the ongoing U.S.-China trade dispute have contributed to the lethargic state of Philippine exports.

24 Of the 1,153 products targeted against China, only 362 of the Philippines' export product lines are similar, compared with Malaysia's 590, Thailand's 553, and Vietnam's 415 product lines. Source: World Bank, Philippine Economic Update, October 2018.

25 World Bank. Global Trade Watch 2018. May 29, 2019 http://documents.worldbank.org/curated/en/549841559120768022/pdf/Trade-Amid-Tensions.pdf

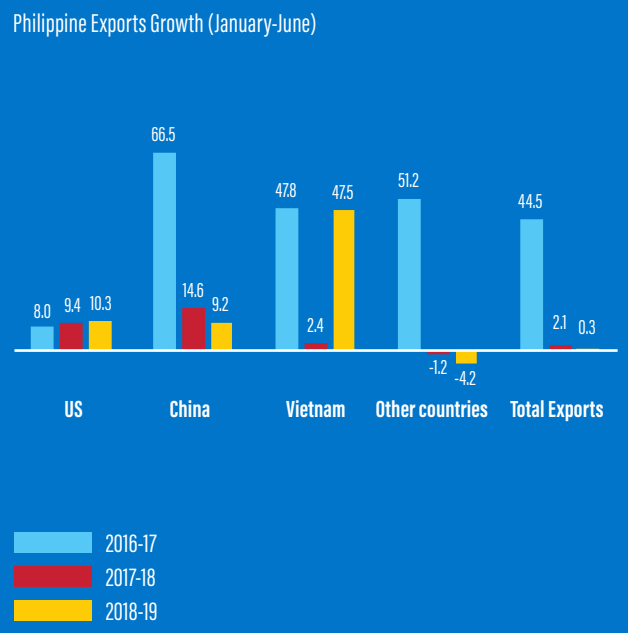
Figure 9.
Global trade growth slowed between 2018 and early 2019.



Source: East Asia and Pacific Economic Update, October 2019

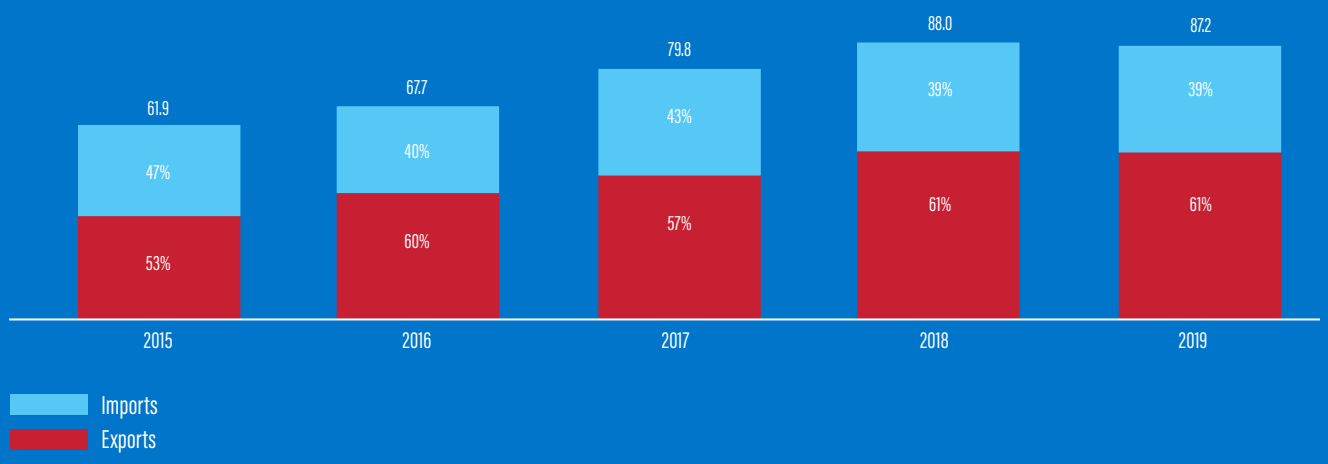
Note: New export orders measured by Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is April 2019 for goods trade, and June 2019 for new export orders. Saar refers to seasonally adjusted annualized data.

Figure 10.
Philippine exports to the U.S. grew slightly faster as exports to China expanded more slowly in H1 2019.



Source: PSA.

Figure 11.
The Philippines' total trade contracted in H1 2019.



Source: PSA.

POSITIVE EXTERNAL POSITION

While weak global demand and heightened trade tensions have dampened the country's net exports, more benign external financing conditions have led to an increase in capital inflows, contributing to a positive external balance, along with the re-accumulation of foreign reserves, in the first half of 2019.

A slowdown in imports amid softer external demand resulted in a narrower current-account deficit in the first half of 2019. Weak global demand and heightened trade tensions dampened the Philippines' merchandise export growth, which contracted by 0.8 percent, yoy, in the first half of 2019 reversing the 1.1 percent growth registered a year ago, continuing the downtrend in export performance which began in early 2018 (Figure 12). The contraction was mainly due to subdued global demand for electronics, the country's main exports, and a slowdown in the electronics cycle. Moreover, merchandise imports contracted by 1.0 percent yoy, a steep reversal compared to the 17.1 percent growth in the first half of 2018 driven by a fall in the import of raw materials and intermediate goods, an indication of lackluster trading activity across the regional value chain, and a significant deceleration in imports of capital goods. Meanwhile, net services export growth decelerated in line with reports of slower growth in the information technology-business process outsourcing (IT-BPO) industry.[26] Growth in personal remittances inched up slightly to 2.9 percent, yoy, in the first half of 2019 from 2.8 percent in the first half of 2018. As a result, the current-account deficit declined to US$0.8 billion (-1.0 percent of GDP) from US$3.8 billion (-2.4 percent of GDP) in the first half of 2018.

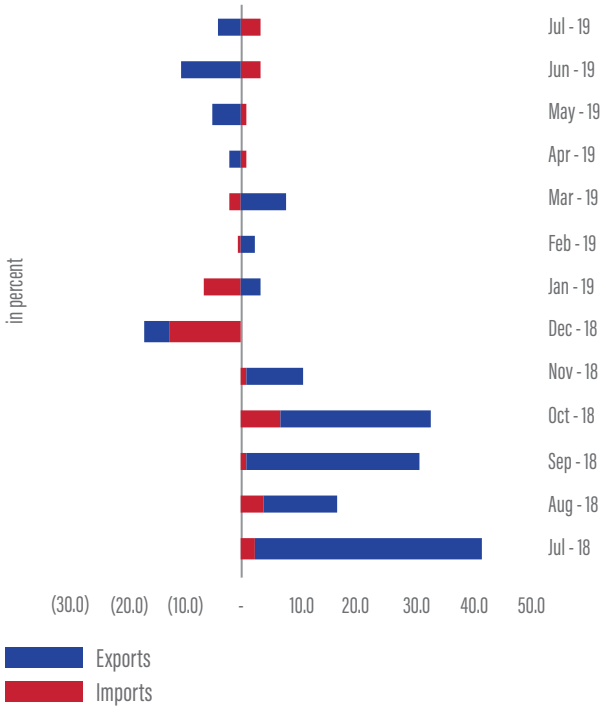
More benign external financing conditions have led to capital inflows in the Philippines more than offsetting the substantial contraction in direct investments and the current account deficit, contributing to a balance of payment surplus. The more dovish stance of the U.S. Federal Reserve since the start of the year contributed to an inflow of capital to emerging markets, including the Philippines where declining inflationary pressure helped improve confidence in the domestic economy. The country's level of portfolio investments reached 2.6 percent of GDP in the first half of 2019, reversing an outflow of 1.7 percent of GDP in the first half of 2018 (Figure 15). The inflow of portfolio investments was channeled through the local stock market and long-term borrowing by the national government, indicating strong foreign demand for domestic debt papers. Foreign direct investment (FDI), however, contracted by 38.8 percent, yoy, from totaling US$5.8 billion in the first half of 2018 to US$3.6 billion in the same period in 2019, likely impacted by uncertainties derived from corporate tax reform CITIRA.[27] Overall, the performance of the Philippines' capital and financial accounts made up for the deterioration in its current account, leading to a larger balance of payment surplus of US$4.8 billion (2.8 percent of GDP) in the first half of 2019—a significant improvement compared to the deficit of US$3.3 billion (-2.1 percent of GDP) in the first half of 2018 (Table 3).

The large capital inflows have resulted in the appreciation of the Philippines' currency and rebuilding of its foreign reserves. The Philippine peso appreciated by 0.2 percent in nominal terms in the first seven months of 2019 relative to the same period in 2018, reaching Php/US$51 in June 2019, compared to Php/US$54 in the third quarter of 2018. In real terms, the Philippine peso appreciated by 5.1 percent, yoy, in the first half of 2019 (Figure 13). The appreciating currency was accompanied by an increase in foreign reserves, which reached US$84.9 billion in June 2019, up from US$77.5 billion in June 2018. The country's foreign reserves currently cover 7.4 months' worth of imports and payment of services and primary income, an improvement from 7.1 months' worth in June 2018.

26 In 2018, actual industry growth of 5.1 percent was lower than the 8.0 percent annual projection based on the industry roadmap 2022. See https://cebudailynews.inquirer.net/247083/rp-remains-leader-in-global-contact-center-industry. While tourism receipts are not yet available, tourism arrivals rose by 9.8 percent year-on-year in the first five months of 2019 from 10.3 percent in the same period last year.

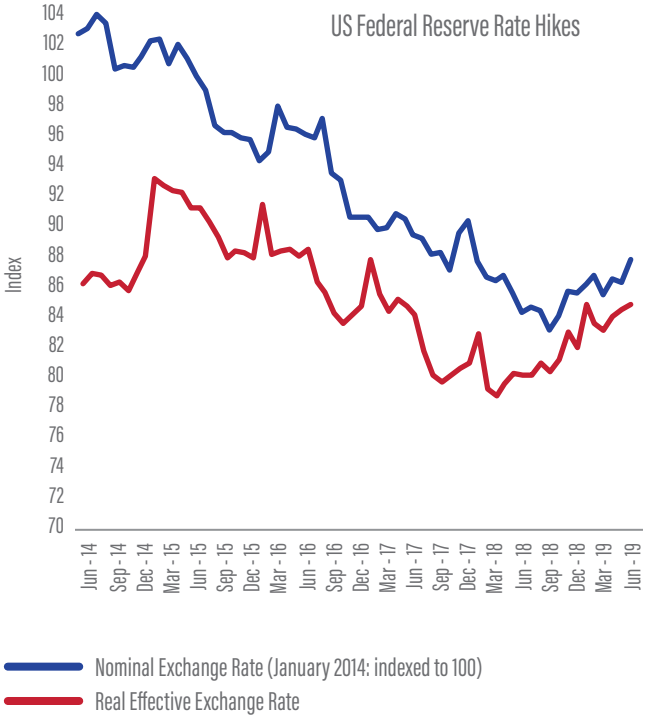
27 Equity other than reinvestment of earnings contracted in key industries such as manufacturing (85.9 percent), finance and insurance (64.0 percent), real estate activities (26.5 percent), and arts, entertainment and recreation (96.1 percent).

Figure 12.
Exports growth contracted while import growth decelerated.



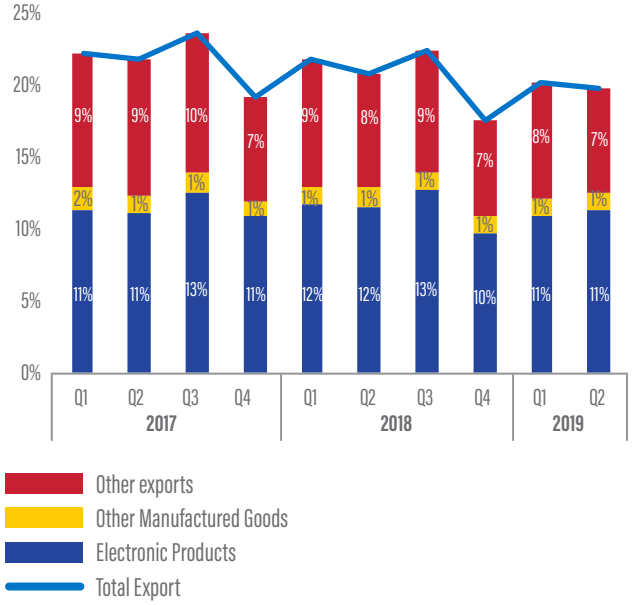
Source: PSA.

Figure 13.
The Philippine peso appreciated in real terms in the first half of 2019.



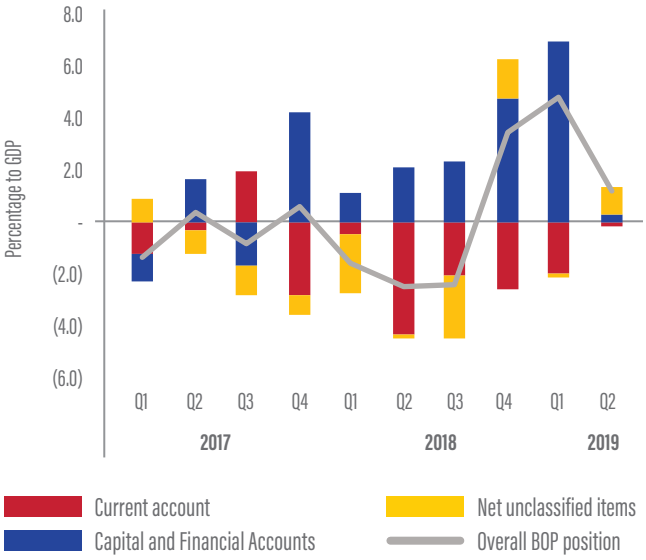
Note: Decrease denotes depreciation.
Source: BSP.

Figure 14.
Philippines export basket (in percent of GDP)



Source: PSA

Figure 15.
Composition of the Philippines' Overall Balance of Payment Position



Source: BSP.

Table 3.
Balance of Payments, H1 2017 to H1 2019

In percentage of GDP

	H1 2017	H2 2017	H1 2018	H2 2018	H1 2019
Current account	**-0.7**	**-0.6**	**-2.4**	**-2.9**	**-1.0**
Goods	-12.2	-13.5	-14.7	-16.1	-13.9
Exports	17.1	16.0	16.3	15.1	15.3
Imports	29.2	29.5	31.0	31.2	29.2
Services	1.8	3.7	3.1	3.9	3.5
Primary Income	1.1	1.0	0.9	1.3	1.5
Secondary Income	8.5	8.2	8.3	7.9	7.9
Capital and Financial accounts	**0.3**	**1.5**	**1.6**	**3.6**	**3.4**
Capital account	0.0	0.0	0.0	0.0	0.0
Financial account	-0.3	-1.4	-1.6	-3.5	-3.4
Direct investment	-2.1	-2.4	-2.3	-1.3	-1.0
Net acquisition of financial assets	0.7	1.4	1.3	1.1	1.1
Net incurrence of liabilities[1/]	2.7	3.8	3.7	2.3	2.1
Portfolio investment	1.9	-0.3	1.7	-0.7	-2.6
Financial derivatives	-0.1	0.1	0.0	0.0	-0.1
Other investments	-0.1	1.1	-0.9	-1.5	-0.3
Net unclassified items[2/]	**-0.1**	**-0.9**	**-1.3**	**-0.1**	**0.5**
Overall BOP position	**-0.5**	**-0.1**	**-2.1**	**0.6**	**2.8**
Memo:					
Basic Balance	1.3	1.7	0.0	-1.6	0.0
Gross International Reserves (in billions USD)	81.3	81.6	77.5	79.2	84.9
Import coverage (in months)	8.4	7.8	7.1	7.0	7.4

1/ Net incurrence of liabilities refers to net foreign direct investment to the Philippines.

2/ The term "Net unclassified items" is a balancing figure. There are two methods of computing the BOP position: the first approach uses the change in net international reserves due to transactions, while the second approach computes the sum balances of the current account, capital account less financial account. The two measures do not necessarily tally. The BSP uses the first approach to determine the overall BOP position.

Note: Following the BSP presentation, the BOP balance = Current Account Balance + Capital Account Balance - Financial Account Balance + Net Unclassified Items.

DECLINING INFLATION HAS RESULTED IN A MORE ACCOMMODATIVE MONETARY POLICY

Inflation declined driven by stabilizing prices of food and energy, prompting the BSP to adopt a more accommodative policy stand in 2019.

Domestic inflation declined in the first half of 2019, driven by stabilizing food and energy prices. The Philippines' headline inflation rate fell from an average of 4.7 percent, yoy, in the first eight months of 2018 to an average of 3.1 percent in the same period in 2019 (Figure 16). From a nine-year high of 6.7 percent in September 2018, the country's inflation rate fell to 1.7 percent in August 2019—its lowest in almost three years. Stabilizing prices of heavily-weighted food and energy items drove the moderation. Food prices declined significantly in the first eight months of 2019 as yoy food inflation averaged 2.9 percent, lower than the 5.9 percent recorded in the same period in 2018. In particular, the domestic price of rice registered only a small increase in the first half of 2019 despite a reduction in the local production of palay or unmilled rice[28] due to an influx of private rice imports (Figure 17).[29] Energy prices in the first eight months of 2019 were also lower than in the same period in 2018, driven by lower international crude oil prices[30] and downward adjustments of local electricity prices. Core inflation, which excludes volatile food and energy items, averaged 3.5 percent in the first eight months of 2019, lower than the 3.7 percent seen in the first eight months of 2018—an indication of a latent upward inflationary pressure from aggregate demand. Both year-to-date headline and core inflation remained within the BSP's target range of 2-4 percent.

28 PSA attributes the estimated 6.5 percent, year-on-year, decline in local palay production to the continuing impact of El Nino. Source: https://www.bworldonline.com/psa-projects-6-5-decline-in-2nd-quarter-palay-output/

29 The rice liberalization law took effect in March 2019. Self-executory provisions include the application of 35 percent tariff rates on rice imported from members of ASEAN, 40 percent if within the minimum access volume (MAV) of 350,000 for rice imported from non-ASEAN countries, and 180 percent if beyond the MAV and from a non-ASEAN country.

30 Average monthly price of crude oil (Brent) in the first five months of 2019 was US$66.31/bbl, down from US$69.83/bbl in the same period in 2018. Source: WBG "Pink Sheet" Data http://www.worldbank.org/en/research/commodity-markets

The BSP adopted a softer monetary policy[31] stance in the first half of 2019, prompted mainly by falling price pressure. The BSP's Monetary Board reduced the overnight reserve repurchase (RRP) by 25-basis-points to 4.5 percent in May 2019, reversing a series of rate increases totaling 175-basis-points since May 2018. After opting for a pause in monetary loosening in June 2019 to observe and assess the impact of the last policy easing measure, the BSP once again trimmed its key policy rate by 25-basis points to 4.25 percent in August 2019. This was done on the back of sustained inflation easing, moderating inflationary expectations, and below-target growth rates in the first two quarters of 2019. In addition, given the continued downtrend in domestic inflation and to mitigate domestic liquidity tightness brought about by limited public spending following the delayed budget approval, a total of 200 basis points were incrementally deducted from the 18 percent reserve requirement ratio (RRR) faced by universal and commercial banks, bringing it to 16 percent by end-July 2019.[32] Likewise, the RRR faced by thrift banks and non-bank financial institutions with quasi-banking functions (NBQBs) underwent a total of 200-basis-point-phased reduction.

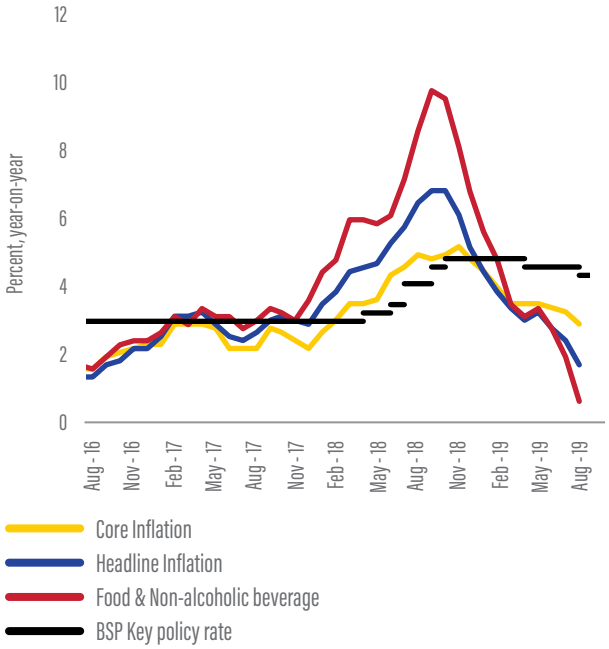
The country's money-supply growth slowed as demand for credit moderated. The country's domestic liquidity (M3) reached Php11.7 trillion pesos and grew by 6.4 percent, yoy, in June 2019, down from 11.8 percent in June 2018 (Figure 18). The slower liquidity growth was driven by rapid policy rate increases adopted by BSP in the second half of 2018 amid higher inflation. Credit to firms grew at 9.4 percent, yoy, in June 2019, substantially lower than 16.7 percent in June 2018. Similarly, the growth of household loans decelerated from 17.7 percent, yoy, in June 2018 to 11.9 percent in June 2019. The sectoral composition of firms' loan portfolios remained broadly unchanged in the past year.

The Philippines' financial system remains stable and resilient. Philippine banks are well capitalized, with a total capital adequacy ratio of 15.3 percent in March 2019, an improvement compared to 14.7 percent in March 2018, and well above the 10 percent regulatory minimum. The share of non-performing loans remains low at an average of 2.0 percent between June 2018 and June 2019, although it has been recently increasing, reaching 2.1 percent in June 2019. The banking sector is highly profitable, with return on equity at an average of 9.6 percent and return on asset at an average of 1.2 percent between July 2018 and June 2019. While these levels are similar those in 2017-18, banks' return on equity has increased and reached 9.8 percent in June 2019. The share of interest income to total operating income averaged 77.1 percent between March and June 2019, and it reached 77.5 percent in June 2019—an indication that lending continues to be banks' core business rather than other fee-based activities.

31 The BSP's approach to monetary policy is based on inflation targeting based as per its mandate to 'promote price stability conducive to a balanced and sustainable growth of the economy.' The BSP uses monetary policy tools such as the reverse repurchase facility, the reserve requirement ratio, acceptance of term deposits, among other monetary policy instruments. The current inflation target for the Philippines is 2 to 4 percent. For a more detailed discussion on the BSP's approach to monetary policy, please refer to: http://www.bsp.gov.ph/monetary/targeting.asp

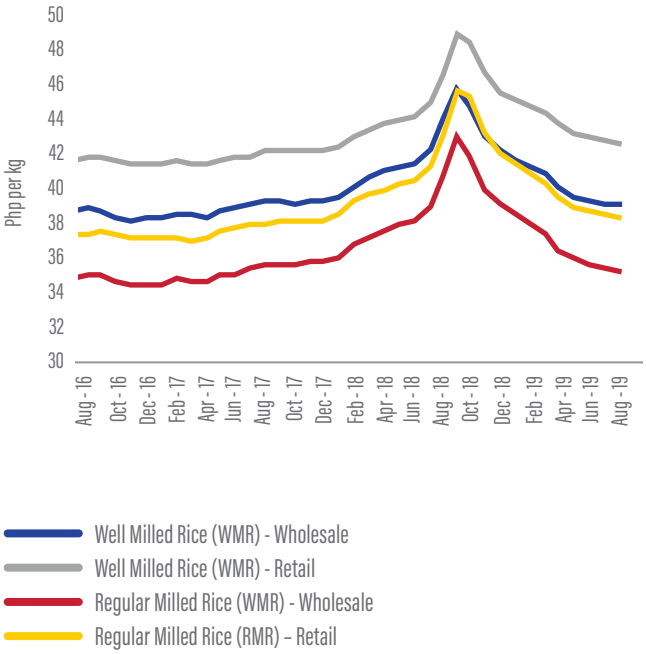
32 This is also part of the BSP's broad financial sector reform agenda to promote a more efficient financial system by lowering financial intermediation costs. Source: BSP, "Monetary Board Reduces Reserve Requirements", Media Release, May 17, 2019. Link: http://www.bsp.gov.ph/publications/media.asp?id=5017&yr=2019

Figure 16.
Sustained inflation easing was observed in H1 2019.



Source: PSA.

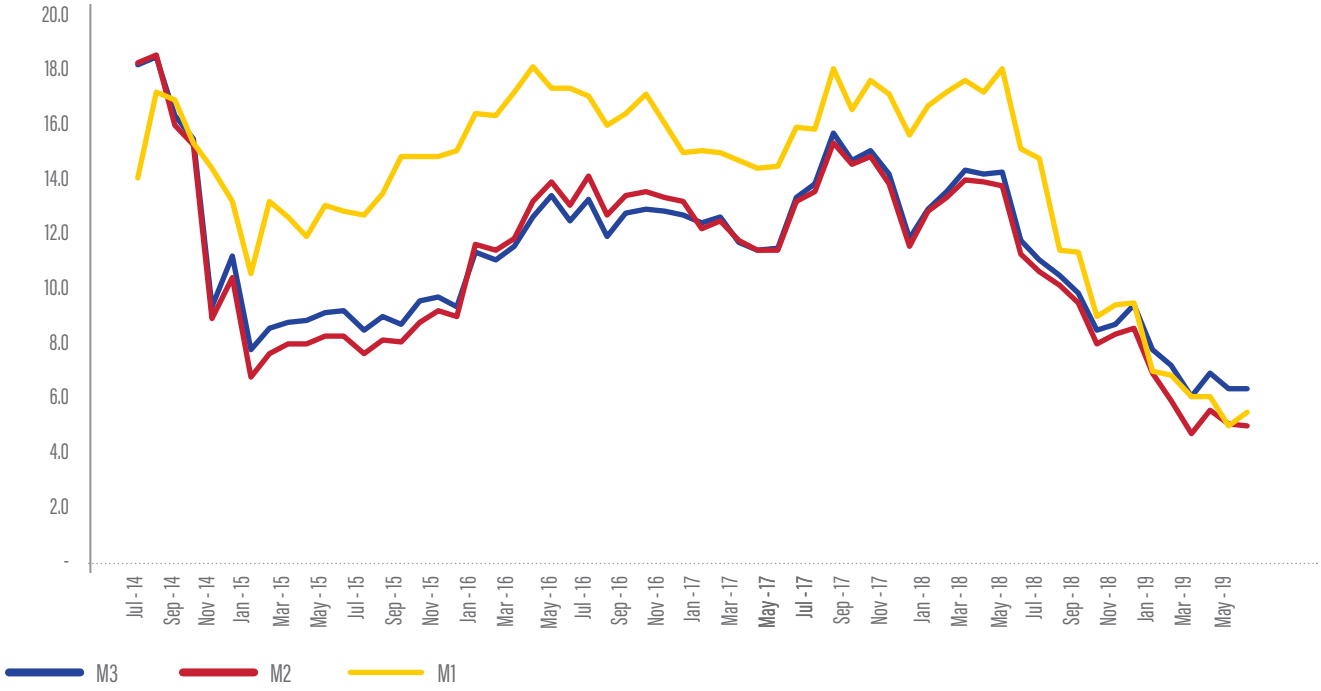
Figure 17.
The price of rice peaked in 2018 but continued to subside in H1 2019 as rice imports increased.



Source: PSA.

Figure 18.
The Philippines' Money-Supply Growth

M1-3 YoY Groth Rates July 2014-June 2019



Source: BSP.

A PAUSE IN FISCAL EXPANSION

The Philippine government's expansionary fiscal policies for 2019 was put on hold as the delayed passage of the 2019 public budget impacted the pace of public spending significantly in the first half of the year, resulting in substantial underspending. Nevertheless, the implementation of previous tax-policy reforms led to robust revenue. As a result, the fiscal deficit was significantly below the programmed target for the first six months of the year.

The fiscal deficit was well below the government's programmed target in the first half of 2019, as authorities struggled to disburse public funds while revenue growth remained robust. Despite the government's expansionary fiscal policy stance in the medium-term, the Philippines' fiscal deficit narrowed from 2.3 percent of GDP in the first six months of 2018 to 0.5 percent of GDP in the same period in 2019—well below the 3.2 percent target for 2019 (Figure 19). The decline in the spending gap was primarily a result of substantial underspending in the first half of the year and continued strong revenue growth. Revenue growth remained robust, albeit at a slower pace compared to the first half of 2018, as tax collections continued to expand at a healthy rate due in part to the second round of increases in excise tax rates under the TRAIN law and supported by tax administration efforts.[33] The government continued to finance its deficit primarily through domestic borrowing (84 percent) in the first half of the year (Figure 22).

The failure to pass the budget in a timely manner resulted in a substantial slowdown in the pace of public spending, leading to underspending in the first half of 2019 (Box 3). Despite the government's commitment to maintain an expansionary fiscal policy stance in 2019, public expenditure contracted by 0.8 percent, yoy, in nominal terms in the first half of 2019, falling short of the programmed target by 7.3 percent (Figure 20). As a result, public expenditure fell from 19.4 percent of GDP in the first half of 2018 to 18.0 percent of GDP in the same period in 2019, as disbursements fell short of the programmed spending target across all spending categories. The decline in public spending was driven by a significant contraction in capital outlays, from constituting 5.4 percent of GDP in the first half of 2018 to 4.3 percent of GDP in the same period in 2019. In particular, public infrastructure and other outlays contracted by 11.7 percent, yoy, in nominal terms in the first half of 2019 (compared to 41.6 percent growth registered a year ago) and falling to 3.5 percent of GDP (4.3 percent of GDP recorded a year ago) in the same period.[34] Likewise, capital transfers to local government units (LGUs)[35] contracted by 29.0 percent, in nominal terms, from constituting 1.1 percent of GDP in the first half of 2018 to 0.7 percent of GDP in the same period in 2019.[36] By contrast, public expenditure on personnel services increased from 5.6 percent of GDP in the first half of 2018 to 5.8 percent of GDP in the first half of 2019, in large part due to the implementation of the fourth tranche of the adjustment related to the salary standardization law,[37] the second round of base pay increases for active military and uniformed personnel (MUP), and adjustments of pension payments for retired MUPs.

33 The Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC) continued to strengthen existing tax administration efforts such as the BIR's program to run after tax evaders (RATE), updating the zonal value schedule, enhanced implementation of Centralized Arrears Management in regional offices, and the BOC's program to strengthen anti-smuggling efforts.

34 The government typically frontloads disbursements during an election year to avoid delays stemming from the spending ban on public works during the election period. For example, infrastructure outlays expanded by 52.3 percent, year-on-year, and 41.4 percent in nominal terms during the past two election years in 2016 and 2013, respectively.

35 Capital transfers to LGUs are automatic appropriations based on shares from national tax collections and are expected to increase in the second half of 2019.

36 Releases made from the Local Government Support Fund (LGSF), which are part of capital transfers to LGUs, are covered by the election ban since funds from the LGSF are used primarily to finance infrastructure outlay projects.

37 The implementation of the fourth tranche of the salary standardization adjustments began in April 2019 after the national government budget was passed into law.

Box 3.
The Impact of the Budget Delay on Utilization and Disbursement in 2019

The Philippine government operated under a reenacted budget for nearly four months in 2019, severely dampening the government's disbursement program. For the first time in nearly a decade, the Philippine government operated under a reenacted budget,[38] in the beginning of 2019 because the Php3.7 trillion 2019 budget was only signed into law on April 15, 2019. No new public programs or projects under the 2019 budget received funding under the reenacted budget, resulting in total public disbursements contracting by 0.8 percent, yoy, in nominal terms in the first half of 2019. In addition, the spending ban[39] on the construction of public works and the non-disbursement of public funds to specific agencies during the 2019 mid-term elections (from March 29 to May 12, 2019) also contributed to the fall in public spending. This resulted in a steep decline in infrastructure outlays (11.7 percent) and capital transfers to LGUs (29.0 percent).

As a result, the government is significantly behind its programmed spending target for the year. The Government of the Philippines has so far disbursed only 42.2 percent of its Php3.769 trillion spending program for 2019, compared to the disbursement rate 47.6 percent in the first half of 2018, with spending on infrastructure outlays posing the most significant challenge for the rest of the year. In the first half of 2019, the government underspent its programmed target for capital outlays by 21.1 percent (Php 101.2 billion), as infrastructure outlays and capital transfers to LGUs fell short of their programmed targets by 20.8 percent and 23.2 percent, respectively. In terms of the full-year budget, only 37.7 percent of the total infrastructure program has been disbursed, with an estimated Php623 billion (an estimated 3.3 percent of GDP) remaining for the rest of the year.

The government has set a spending catch-up plan in motion, which aims to reverse the slow pace of public disbursements in the first half of 2019. The plan is centered around fast-tracking the implementation of the government's infrastructure and socioeconomic programs. In terms of infrastructure outlays, the success of the government's catch-up plan hinges on the ability of the Department of Public Works and Highways (DPWH) and the Department of Transportation (DOTr) to implement their combined Php803.1 billion spending program for the year.[40] In addition, infrastructure spending by other key line agencies are expected to contribute to disbursement growth in the second half of the year, provided that agencies are able to accelerate the implementation of their proposed capital outlay projects.[41] Meanwhile, the government has committed to accelerate the implementation of priority socioeconomic programs such as the National ID Program, the *Pantawid Pamilyang Pilipino* Program, and the fuel marking program. In order to support the timely execution of the government's cash-based budget for the remainder of 2019, the Department of Budget and Management (DBM) already processed the release of cash allocations to line agencies on July 1, 2019.

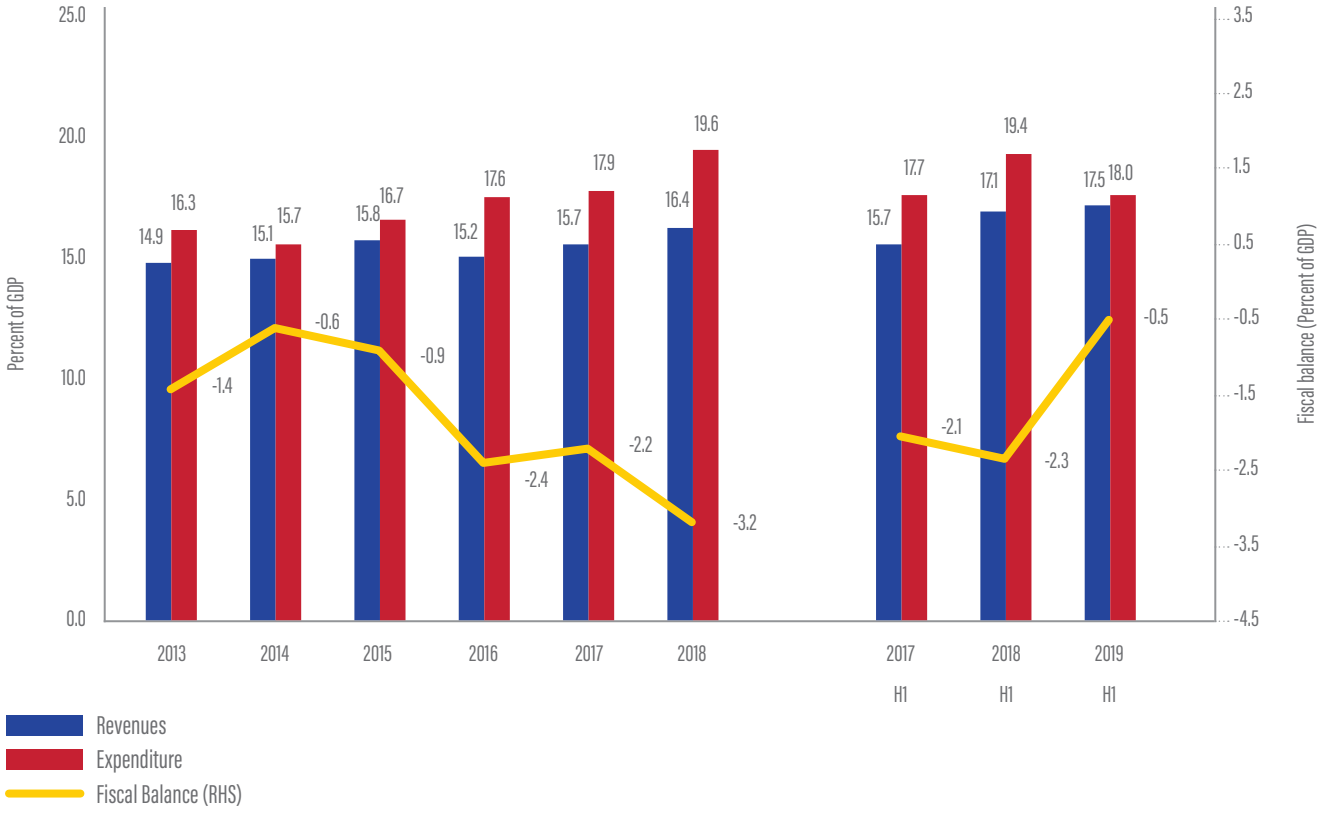
38 In 2019, the Government of the Philippines operated under a reenacted budget until April 15, 2019 when the president signed Republic Act No. 11260, or the General Appropriations Act for Fiscal Year 2019. Under the 1987 Constitution, if the Philippine government is unable to pass the General Appropriations Bill (GAB) by the end of the year, the Philippine government will operate under the previous year's budget until the government passes the GAB.

39 Based on Commission on Elections Resolution No. 10511.

40 This represents around 80 percent of the total infrastructure program for the year and 21.3 percent of the year's total disbursement program.

41 For example, the Department of Finance cites disbursements from the Department of National Defense on the Armed Forces of the Philippines' Modernization Program, the school building programs of the Department of Education, and the health facilities enhancement program of the Department of Health. Source: https://business.inquirer.net/271193/govt-launches-bold-spending-catch-up-plan-to-reverse-slow-q1-growth

Figure 19.
National Government Fiscal Balance, 2013-H1 2019



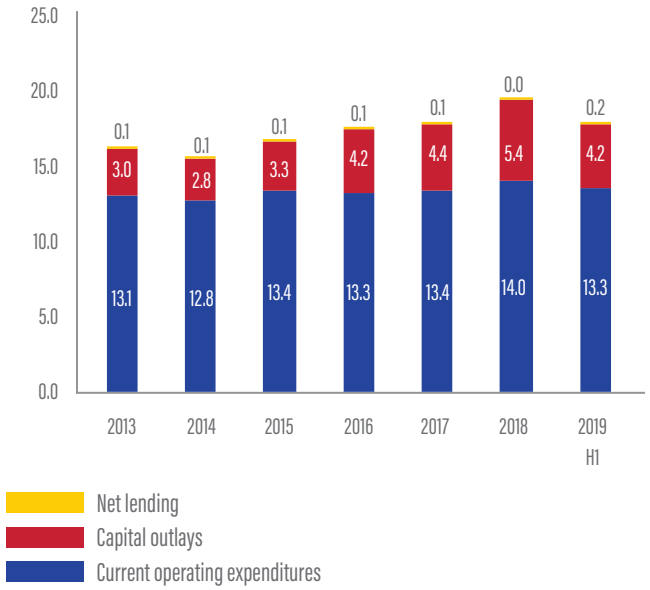
Source: Bureau of the Treasury.

Public revenue growth continued its strong momentum in the first half of 2019, slightly exceeding the government's programmed target. The government registered robust revenue growth in the first half of 2019, reaching 17.5 percent of GDP—slightly exceeding its programmed target by 0.3 percent (Figure 21). Strong public revenue growth was fueled by the continued improvement in tax collection, which rose by 10.0 percent, yoy, in nominal terms in the first half of 2019, benefitting from the second round of excise tax hikes under the TRAIN law and continued efforts by the government to improve the tax administration. As a result, the tax ratio improved slightly from 15.2 percent of GDP in the first half of 2018 to 15.6 percent of GDP in the same period in 2019—a substantial increase compared to the pre-reform tax ratio of 14.2 percent of GDP.

The Philippines' overall fiscal health remains sound, although the public debt ratio increased compared to the previous year. The government's commitment toward implementing an expansionary fiscal policy and slower pace of nominal GDP growth has resulted in a modest increase in the national government public debt ratio, from 42.5 percent of GDP in 2017 and 2018 to 43.7 percent of GDP in the first half of 2019 (Figure 23). Despite the increase, debt metrics remain favorable toward maintaining long-term fiscal sustainability. The country's debt portfolio is composed largely of long-term debt (76.0 percent), while around two-thirds of the country's total debt is composed of peso-denominated debt.[42]

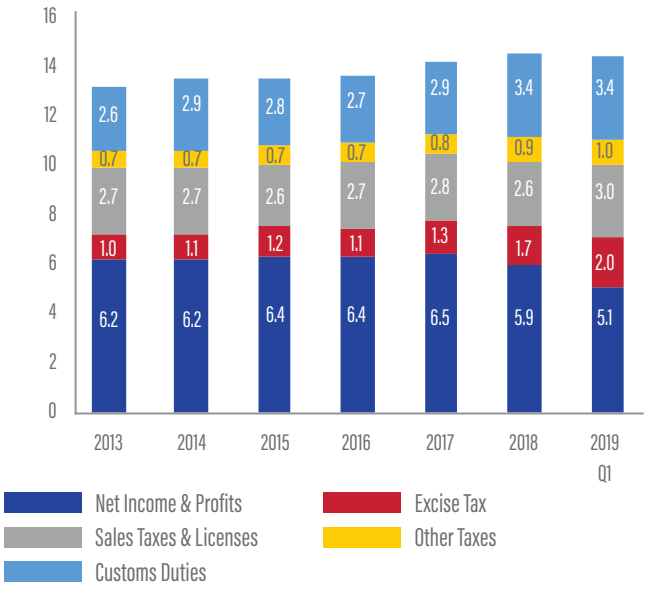
42 The Philippine government's domestic debt accounts for around 67.3 percent of the total debt stock, around two-thirds of which are long-term in nature. 97.5 percent of the country's external debt is long-term in nature. As a whole, 8.3 percent of the country's total debt stock is short-term in nature.

Figure 20.
National Government Expenditure by Component (% of GDP)



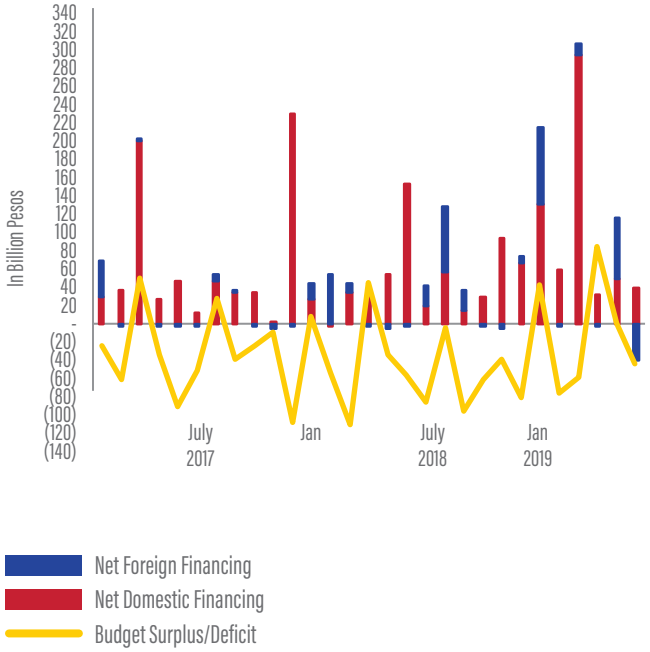
Source: DBM, PSA.

Figure 21.
National Government Tax Collection by Type (% of GDP)



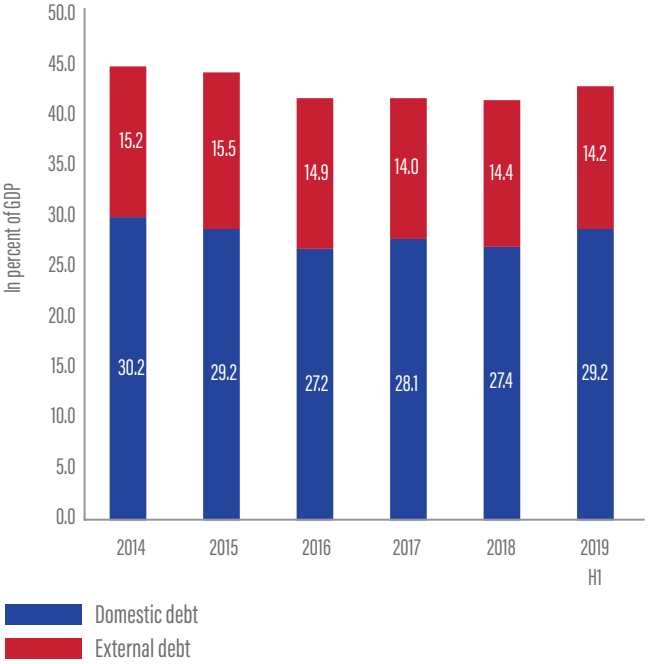
Source: DBM, PSA.

Figure 22.
The government continues to finance its deficit mainly through domestic borrowing.



Source: Bureau of Treasury.

Figure 23.
The overall debt-to-GDP ratio increased slightly in H1 2019.

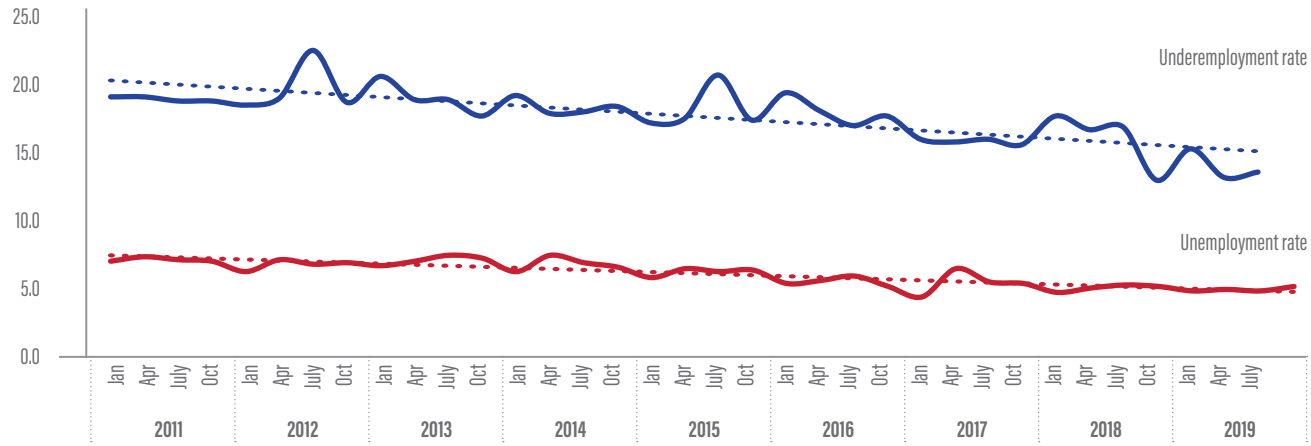


Source: Bureau of Treasury, PSA.

IMPROVING LABOR MARKET CONDITIONS LED TO PROGRESS ON POVERTY REDUCTION

The labor market of the Philippines continued to be vibrant, as unemployment and underemployment rates recorded their lowest levels in over a decade. Sustained growth in real household income among the poor over the past 3 years have resulted in lower poverty rate in the first half of 2019.

Figure 24.
Unemployment and underemployment rate (Percent)



Source: Labor Force Survey (various rounds), PSA

The Philippines maintained its low unemployment in July 2019, indicating continued labor market tightness. Unemployment rate was at 5.4 percent in July 2019 (2.4 million people) — its lowest in over a decade (based on July rounds of the labor force surveys). This is slightly below the 5.5 percent average in 2015-18, but moderately above the government's target of 4.3-5.3 percent for 2019 (Figure 24). While the country's low unemployment rate signals a tight labor market, unemployment remains a major concern among the youth (aged 15-24), as the youth unemployment rate reached 14.4 percent, or approximately thrice the national rate, early in the third quarter of 2019. By region, the highest unemployment rates were recorded in the more urbanized areas, such as the CALABARZON (7.2 percent), the National Capital Region (NCR) (6.1 percent), and the Central Visayas (6.0 percent).

Underemployment rates dropped, particularly in regions outside of the NCR. Underemployment, or the proportion of employed persons who desire to work more hours or an additional job, has persisted to be double the unemployment rate, but it has declined over time. The underemployment rate averaged 16.9 percent 2015-18, before falling considerably to 13.9 percent in July 2019 (6.0 million people)— equivalent to about 1 million less underemployed workers from last year's 7 million. As the NCR has continuously recorded the lowest underemployment rates, the government has prioritized curbing underemployment in regions outside the capital. Government efforts to reduce underemployment such as emergency employment and livelihood programs, yielded results early in the third quarter of 2019, as underemployment in non-NCR regions reached 15.8 percent, below the annual government target of 17.4-19.4 percent for 2019.

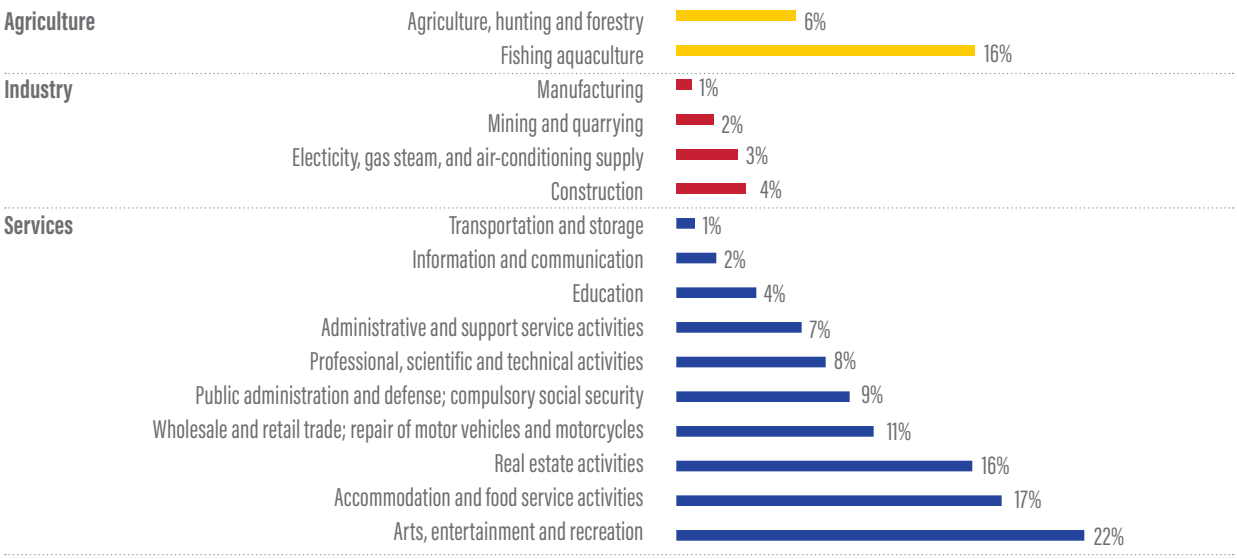
Nonetheless, the government needs to intensify its efforts to develop the industry sector and reduce vulnerable work in order to sustain recent progress in improving underemployment. The share of employment in the services sector, mostly low-end service jobs, expanded slightly to 57.8 percent in July 2019. By contrast, the share of the industry sector, which on average has higher paid jobs than the services sector, contracted from 19.4 percent in July 2018 to 18.7 percent in July 2019. In addition, the share of vulnerable workers, comprised of self-employed and unpaid family workers, considerably increased from 31 percent in July 2018 to 34 percent in July 2019.

Despite the budget deadlock in the Congress of the Philippines early this year, job creation expanded in July 2019, mainly driven by the agriculture and services sectors. After recording job losses of 379,000 in the beginning of 2019, job creation picked up in the succeeding period. In July 2019, 2.3 million jobs were created, yoy, which exceeded the government target of 900,000 to 1.1 million jobs for 2019 and approximately five times the 480,000 additional jobs recorded for the same period last year. While the job creation was broad-based, the main growth drivers were the agriculture and services sectors, which grew at 8 percent (10.1 million) and 6 percent (24.8 million) yoy respectively (Figure 25). The industry sector trailed behind with 2 percent growth (8.0 million) yoy. Within the services sector, the highest job growth in absolute terms was recorded in wholesale and retail trade, accommodation and food service activities, transportation and storage, and public administration and defense, and compulsory social security (Figure 26), which may be attributed to the transition period of those who recently assumed office as a result of the Philippine midterm elections as well as the increased consumer demand during the summer period.[43] Meanwhile, after a sluggish employment growth in the first quarter of 2019, the construction sector moderately picked up. 207,000 jobs and 140,000 jobs were added in April and July 2019, compared to same period last year, respectively. The slowdown was expected, as the four-month budget impasse in Congress at the start of the year severely held back public spending on infrastructure and social services.[44]

43 4.1 million foreigners have visited the country from January to June 2019, indicating an 11.4% increase from 2018. The tourism industry has generated 245 billion pesos in receipts from international visitors for the same period. Source: Department of Tourism

44 Based on the National Income Accounts of the PSA, government final consumption expenditure grew by only 6.9 percent in the second quarter of 2019, down significantly from 11.9 percent in the same period in 2018. Growth in public construction contracted by 27.2 percent in the same period.

Figure 25.
Job Creation Growth by Subsector (%)



Source: Labor Force Survey (July 2018 and July 2019 rounds), PSA.

Figure 26.
Top 10 Subsectors with Most New Jobs (100,000s)

Source: Labor Force Survey (April 2018 and April 2019 rounds), PSA.

On the supply side, the country's labor force participation rate (LFPR) increased as more people in their prime workforce age and women become economically active. After a persistent decline during the past 2 years, the LFPR, representing the workforce engaged in work or available for work, has started to pick up, increasing from 60.1 percent in July 2018 to 62.1 percent in July 2019—equivalent to 2.4 million labor market entrants (Figure 27). More women entered the labor force, as the LFPR among women increased from 46.5 percent in July 2018 to 47.4 percent in July 2019. By age group, the highest increase in the LFPR came from people in their prime workforce age of 35-44, followed by people aged 24-34. Meanwhile, the anticipated LFPR impact of the two cohort graduations of the Senior High School (SHS) program, which meant that some HS graduates may start to work, is noticeable but seems only partial. The LFPR of the 15-24 age group increased from 36.8 percent in July 2018 to 38.3 percent in July 2019, equivalent to 230,000 youth. This suggests that bulk of SHS graduates may have pursued further studies, particularly to avail of the benefits from the Universal Access to Quality Tertiary Education Act.[45] In 2016, a few months before SHS was first implemented, about 65.9 percent of the

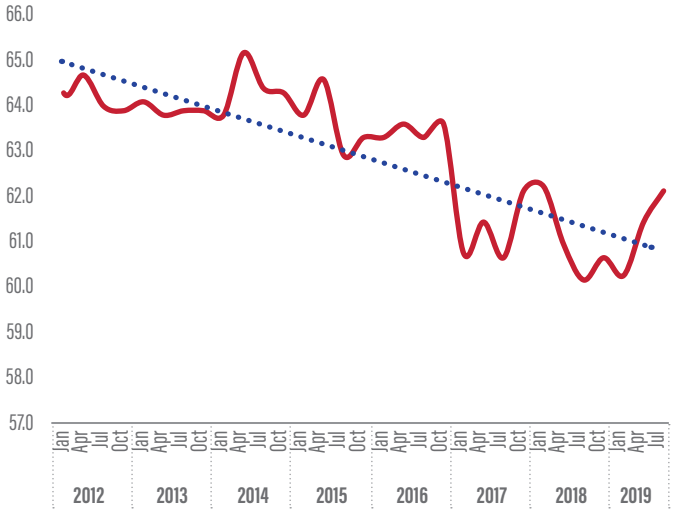
45 Republic Act 10931 also provides free tuition in state-run technical-vocational institutions, establishes tertiary education subsidies and student loan programs, and strengthens the unified student financial assistance system for tertiary education.

country's youth not in the labor force cited schooling as the reason for not looking for work. This has significantly increased to 77.8 by 2019 (Figure 28).

Real wage reached highest level over the past decade boosting household incomes in early 2019. The real daily wage has increased over time, peaking in the first quarter of 2019. In January 2019, the daily wage averaged Php392 (in 2012 prices), a 4.5 percent increase from the same period in 2018 (Figure 29). This was likely due to regional wage hikes enforced in the last quarter of 2018.[46] Meanwhile, the movement of workers from agricultural employment to non-agricultural jobs has continued, reflected in the structure of household income. During the first half of 2018, wages accounted for 49.5 percent of total household income from 46.6 percent share in the same period in 2015. This has been especially evident among households in the bottom quintile, where the share of wages in total income increased from 32.5 percent in 2015 to 36.9 percent in 2018 (Figure 30). Consequently, the share of entrepreneurial incomes (mostly agriculture based) contracted to 22.2 percent, about 4-percentage point drop from the estimated share in 2015.

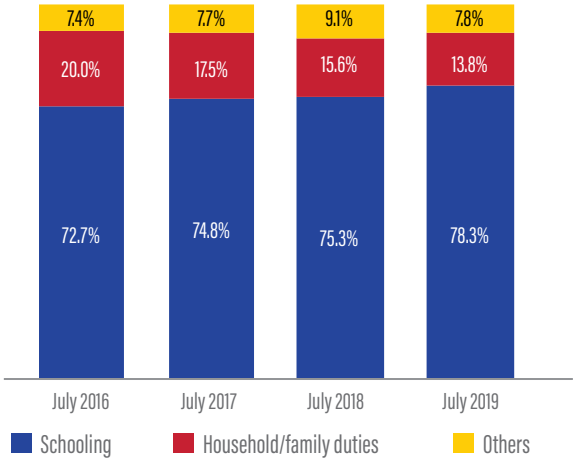
The incidence of poverty declined significantly in the first half of 2018. The latest official estimates from the PSA show that the country's poverty rate declined from 27.6 percent in the first six months of 2015 to 21 percent in the same period in 2018. Almost all regions, except for the NCR and ARMM, experienced a reduction in poverty (Figure 31). The Ilocos Region showed the largest decline, as its poverty rate fell by more than half, from 25.8 percent in 2015 to 11.8 percent in 2018. Other regions that experienced a substantial reduction in the incidence of poverty (at least 30 percent) include CALABARZON, CAR, Bicol, MIMAROPA, Western Visayas, and Central Luzon. While these initial estimates are promising, the high rate of inflation recorded in the second half of 2018 especially affected lower income households and may have dampened the poverty-reducing gains from higher wage and salary incomes.[47]

Figure 27.
Labor Force Participation Rate



Source: Labor Force Survey (various rounds), PSA.

Figure 28.
Reason for Not looking for Work among Youth (15-24) Not in the Labor Force (%)



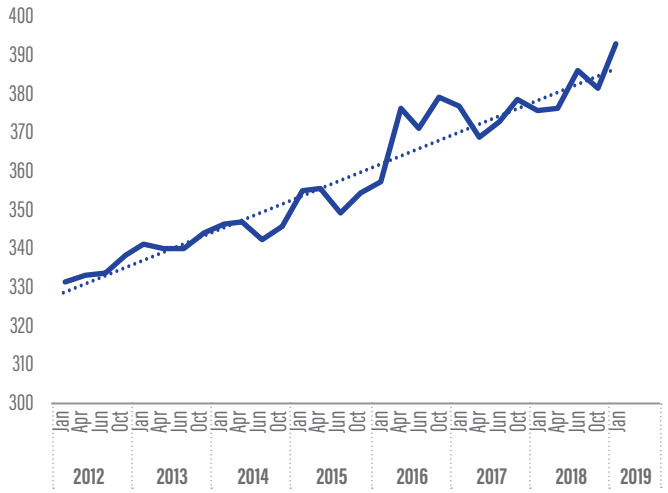
Note: 'Others' include tired/believe no work is available, awaiting results of previous job application, temporary illness/ disability, bad weather, waiting for rehire/job recall, too young/old, or retired/ permanent visa.

Source: Labor Force Survey (various rounds), PSA.

46 Wage hikes were effective in NCR, Region II, Region IV-B, Region 10 during the last quarter of 2018. In April 2019, a wage hike was effective in Region I. Source: Minimum wage data from the National Wages and Productivity Commission.

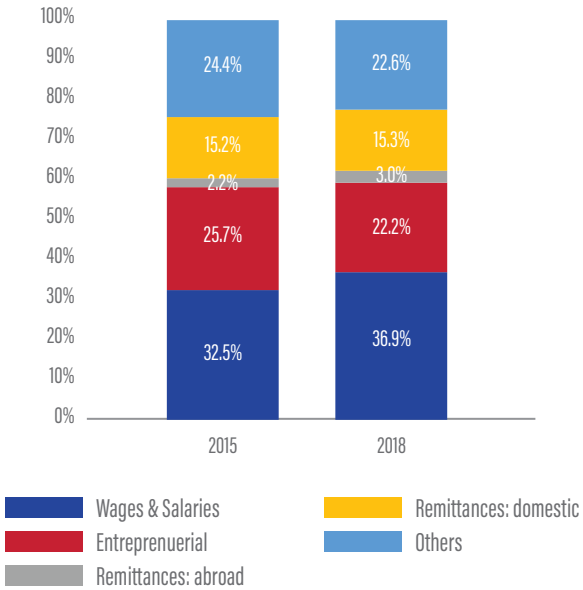
47 In the last decade, the incidence of poverty in the second semester has been consistently lower than in the first, which has compensated for the higher estimates for the first semester. The government's full-year poverty incidence target for 2018 was between 17.3 and 19.3 percent.

Figure 29.
Average Daily Real Wage (Measured in Constant 2012 Php)



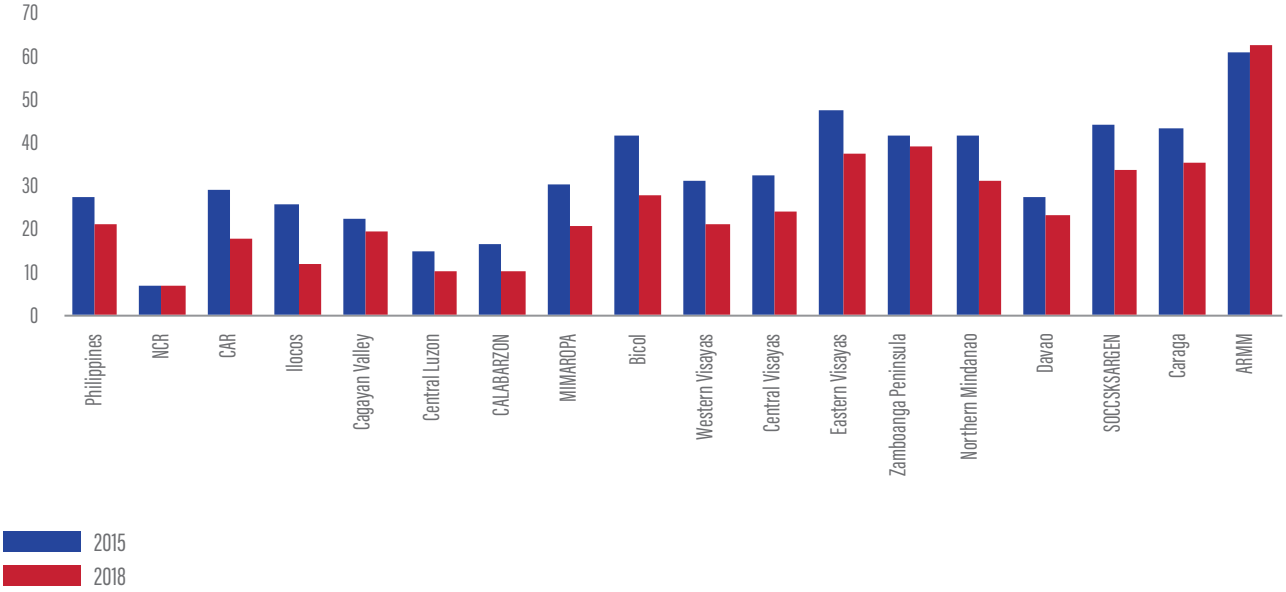
Source: Staff estimates using Labor Force Survey (various rounds), PSA.

Figure 30.
Components of Household Income (Households in the Bottom Income Quintile)



Source: PSA and WB Staff Calculations.

Figure 31.
Poverty Incidence in the First Semester, 2015 and 2018 (%)



Source: PSA.

02

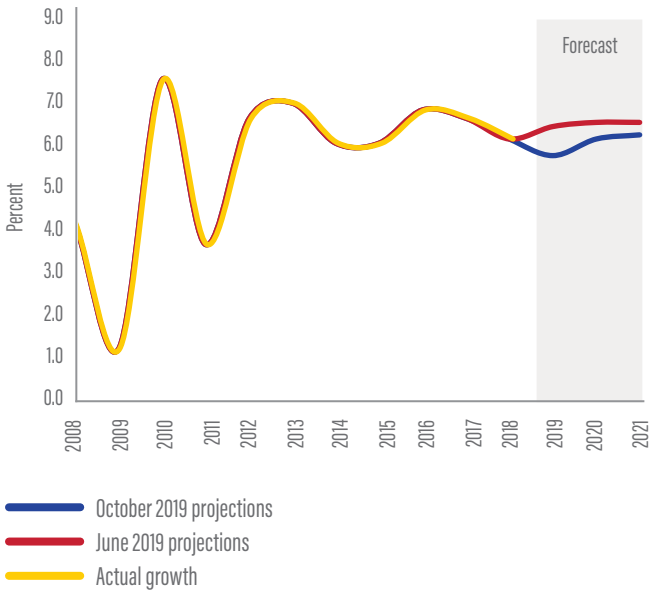
OUTLOOK AND RISKS

GRADUAL ECONOMIC GROWTH RECOVERY

The Philippine economy is projected to grow at a slower pace in 2019 compared with 2018 amid a weak external environment and domestic challenges. Economic growth will be driven by robust private consumption and recovering public investment growth, although it will be hampered by weak export performance.

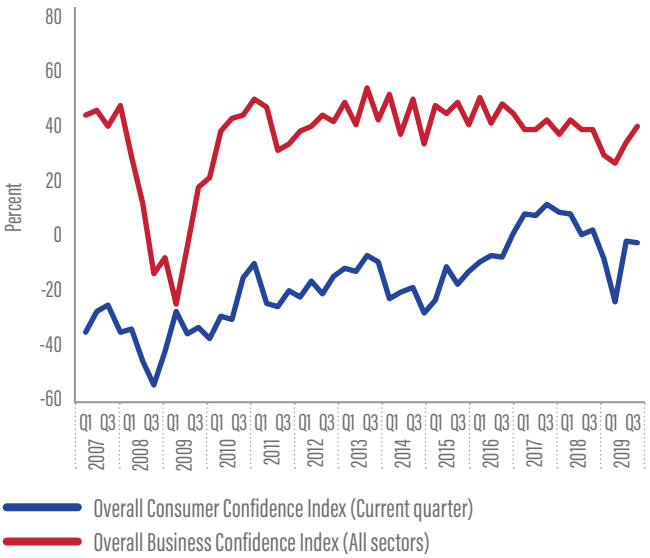
The Philippines' growth outlook is weakened by a difficult external environment and domestic challenges. The World Bank projects the country's real GDP growth at 5.8 percent in 2019, before recovering to 6.1 percent in 2020 and 6.2 percent in 2021 (Figure 32). These estimates are lower than the previous growth projections of 6.4 percent in 2019 and 6.5 percent in 2020 and 2021, reflected in the June 2019 edition of the Global Economic Prospects. The downward revisions incorporate downside risks that have materialized since the April 2019 edition of the Philippines Economic Update, such as the slowdown in public spending, particularly on infrastructure, prevailing market anxiety about the impact of global economic developments on the Philippine economy, including weak global manufacturing activity and trade, as well as heightened uncertainty from escalating trade tensions. The domestic drivers of growth, especially capital formation, are expected to grow at a lower rate in 2019 relative to 2018, hampered by the effects of the budget delay and the May election spending ban. Private consumption growth, despite recording a mild slowdown in the second quarter, is expected to accelerate in 2019 compared with 2018. Given the weak external environment, net exports will remain subdued. Nevertheless, economic growth is expected to surpass 6.0 percent in 2020-21 as global growth is expected to moderately improve in the next two years, the impact of this year's public expenditure slowdown dissipates, and assuming the uncertainty around the passage of the Corporate Income Tax and Incentives Rationalization bill is resolved.

Figure 32.
Real GDP is expected to grow at 5.8 percent in 2019, before accelerating in 2020-21.



Source: PSA, World Bank staff calculation.

Figure 33.
Confidence has improved since the significant drop in the last quarter of 2018.



Source: BSP.

The government's fiscal policy will remain supportive of growth, as public expenditure growth is anchored in the acceleration of investment spending. The Philippine government is expected to continue its expansionary fiscal policy in the medium term, as public disbursements are set to expand by 10.6 percent in nominal terms in 2019 and reach Php4.2 trillion and Php4.7 trillion in 2020 and 2021, respectively. The sustained rise in public spending will be anchored in the government's investments in infrastructure and human capital development. In particular, infrastructure outlays are set to expand by 12.3 percent (to reach Php1.1 trillion, or 5.3 percent of GDP) and 26.8 percent (to reach Php1.4 trillion, or 6.1 percent of GDP), yoy, in 2020 and 2021, respectively. Current operating expenditures meanwhile are expected to increase slightly to 14.5 percent of GDP in 2020 from 14.2 percent of GDP in 2019, as the government implements the fifth tranche of the public-wage adjustments under the salary standardization law.

However, underspending due to the delayed passage of the 2019 budget and concerns over project-delivery constraints will likely result in a lower fiscal deficit relative to the government's target. While authorities plan to accelerate the pace of infrastructure spending to compensate for underspending in the first half of the year, the World Bank forecasts a lower deficit for 2019, as disbursements will likely fall short of the programmed target despite the government's efforts to implement a catch-up spending plan in the second half of the year. The pace of spending will likely pick up in succeeding years under the assumption that future budgets are passed in a timely manner. While the government has maintained its fiscal deficit target for 2020 and 2021 at 3.2 percent of GDP, implementing capacity constraints coupled with cash basis budget will likely challenge the government to reach the target.[48]

The growth forecast assumes a loosening of the BSP's monetary stance. With inflationary pressure steadily diminishing since October of last year, the BSP started to pursue a more accommodative monetary stance in 2019. The declining inflation trajectory is expected to continue in succeeding months due to base effects, coupled with lower food and energy prices.[49] Rice inflation is expected to decline further as continued private-sector imports augment the domestic supply. Global crude oil prices are expected to moderate as well, barring significant turmoil in oil-producing countries, as trade tensions are expected to have a direct impact on the demand for oil. As a result, oil prices are projected to fall from US$68.00/barrel (bbl) in 2018 to US$66.00/bbl and US$65.00/bbl in in 2019 and 2020, respectively. Given the declining inflation trajectory, along with temporary weaker growth, and the 175 basis points increase adopted in 2018, the BSP has the policy space to adopt a more accommodative monetary policy in the medium term. Furthermore, an interest rate cut of 25 basis points by the U.S. Federal Reserve in July 2019 affords the BSP more space to pursue additional rate cuts.

With declining inflation and improving labor market conditions, household consumption growth is expected to accelerate in 2019. Private consumption is estimated to accelerate from 5.6 percent, yoy, in 2018 to 5.9 percent in 2019, driven by lower inflation, which improves households' purchasing power and increases consumption demand, and improving labor market conditions, supported by the implementation of infrastructure projects that will generate job opportunities. This will contribute to improved consumer confidence, which recovered in the first two quarters of 2019 after falling significantly in the last two quarters of 2018 (Figure 33). The 2019 confidence index, despite marginally lower in the first half of year, remains positive, signifying more optimism than pessimism in the Philippine economy. Meanwhile, remittance inflows,

48 As the government shortens the grace period for cash budget implementation in 2020 and 2021 that allows disbursement beyond the budget year, and that the number of previous years projects reduces as they get implemented, the government needs to resolve procurement and implementing challenges so new projects can be procured and implemented within the budget allowed period. Between 2017-2018 disbursement performance of DPWH and DOTr has not improved much. Disbursement rate of DPWH increase slightly from 34.1 percent in 2017 to 39.2 percent in 2018 while DOTr's disbursement rate has declined from 25.6 percent in 2017 to 20.6 percent in 2018, both due to absorptive capacity constraints given rapid increase in budget allocation since 2017.

49 As of Q2 2019, inflation in commodity prices in 2019 are expected by both consumers and businesses to remain within but at the upper bound of the 2-4 percent target of the government. Firms expect inflation to rise in Q3 2019 to 4 percent, while consumers anticipate a 4 percent inflation rate over the course of the next 12 months.

Table 4.
Economic Indicators for Baseline Projections

	2016	2017	2018	2019f	2020f	2021f
Real GDP growth, at constant market prices	6.9	6.7	6.2	5.8	6.1	6.2
Private Consumption	7.1	5.9	5.6	5.9	5.9	6.0
Government Consumption	9.0	7.0	13.0	7.4	10.6	10.2
Gross Fixed Capital Investment	26.1	9.5	12.9	6.1	13.6	13.7
Exports, Goods and Services	11.6	19.5	13.4	5.9	8.0	8.3
Imports, Goods and Services	20.2	18.1	16.0	6.5	11.3	11.7
Inflation (period average)	1.3	2.9	5.2	2.9	3.0	3.0
National government balance (% of GDP)	-2.4	-2.2	-3.3	-2.0	-2.7	-2.8
Current account balance	-0.4	-0.7	-2.7	-2.0	-2.5	-2.7

riding on the sustained deployment of overseas Filipinos, remains steady, although at lower rates compared to previous years.

Weak external demand will likely continue to weigh on the country's export growth. Global growth is projected to decline from 3.0 percent in 2018 to 2.5 percent in 2019-2020, before rising to 2.6 percent in 2021 (Box 4). Growth among advanced economies will be substantially lower at 1.6 percent in 2019 and 1.4 percent in 2020-21, which will soften the demand for Philippine goods, as roughly 70 percent of the country's exports are destined for high-income economies. In addition, a prolonged global technology downturn will hurt the Philippines' export performance since electronics components constitute nearly half of the value of its exports.[50] . Net services exports will be supported by the tourism and BPO sectors, although their growth will likely be modest given the weak external demand. While the demand for overseas Filipinos remains strong, with new opportunities in advanced economies like Japan and Germany, future growth in remittances will be modest due to an already high base. Beyond external demand, export competitiveness remains a challenge, as the country has not progressed in diversifying its export goods.

The current account is expected to remain in deficit during the forecast horizon, driven primarily by a large merchandise trade deficit and import acceleration. The large trade deficit will not be offset by the growth of net services exports and net factor income from abroad. Imports will likely intensify, outpacing export growth but at a slower pace compared to 2018 before eventually rising in 2020-21, trailing domestic demand. Acceleration in the implementation the government's public infrastructure program will increase the import of capital goods while steady household demand will drive consumer goods imports.

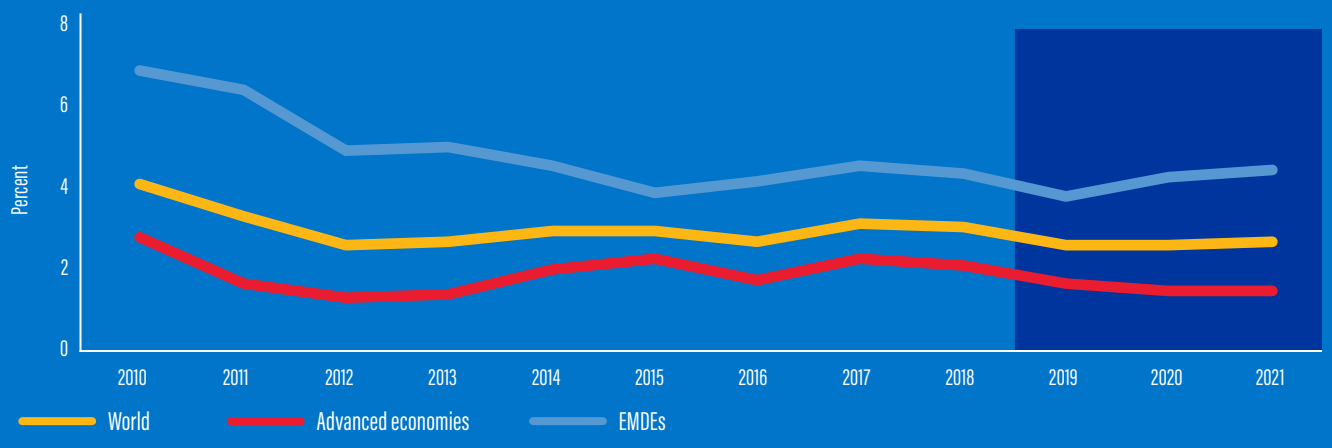
50 A prolonged technology downturn is anticipated in view of the escalating U.S.-China trade war and brewing trade tensions between Japan and Korea.

Box 4.
Global Outlook

Global economic growth is expected to slow due to weakness in international trade and investment performance. Global growth is expected to decelerate from 3.0 percent in 2018 to 2.5 percent in 2019 (Figure 34). Weaknesses in both trade and investment are observed in both advanced economies and EMDEs, driven by an escalation of trade disputes between major economies, as well as increased policy uncertainty[51] that weigh on business confidence and delay investment and export decisions. Economic activity in major economies is expected to slow down as the effect of the U.S. fiscal stimulus begins to wane, China's rebalancing and deceleration are projected to persist, and manufacturing and export sectors in major European countries continue to deteriorate amid a worsening global trade environment. Meanwhile, growth in EMDEs is expected to soften in 2019 due to below-average investment growth, dragged down by contractions in economies under financial stress[52] and sanctions.[53] Economic growth in many Asian countries will likely remain robust, albeit with gradual deceleration, as countries such as China, India, Cambodia, and Vietnam will register 6-7 percent growth in 2020-21.

Global financial conditions are projected to be accommodative to growth as central banks in major economies adopt dovish monetary policy stances. The sluggish growth outlook and low inflation expectations in advanced economies are expected to prompt the adoption of accommodative monetary policies. For example, the U.S. Federal Reserve cut its policy rate by 25 basis points in July 2019—its first rate cut since 2008, while the European Central Bank has delayed ending its negative interest rate policy. This is expected to relieve some financial stress in EMDEs previously hampered by tight financial conditions, especially in countries with elevated debt levels. The change in expectations about interest rates (Figure 35) has already contributed to a drop in long-term yields, which has improved many EMDEs' external financial conditions and portfolio flows. On the other hand, heightened uncertainties brought about by the on-and-off escalation of the trade war between the U.S. and China, emerging disputes between Japan and Korea, and geopolitical tensions in the Middle East have translated to considerable volatility in financial markets.[54] Although supportive global financial conditions are projected to persist in the near term, the eventual tightening of monetary policies in advanced economies in the medium term pose negative risks to EMDE capital flows.

Figure 34.
Global GDP Growth Outlook



Source: EAP Economic Update October 2019

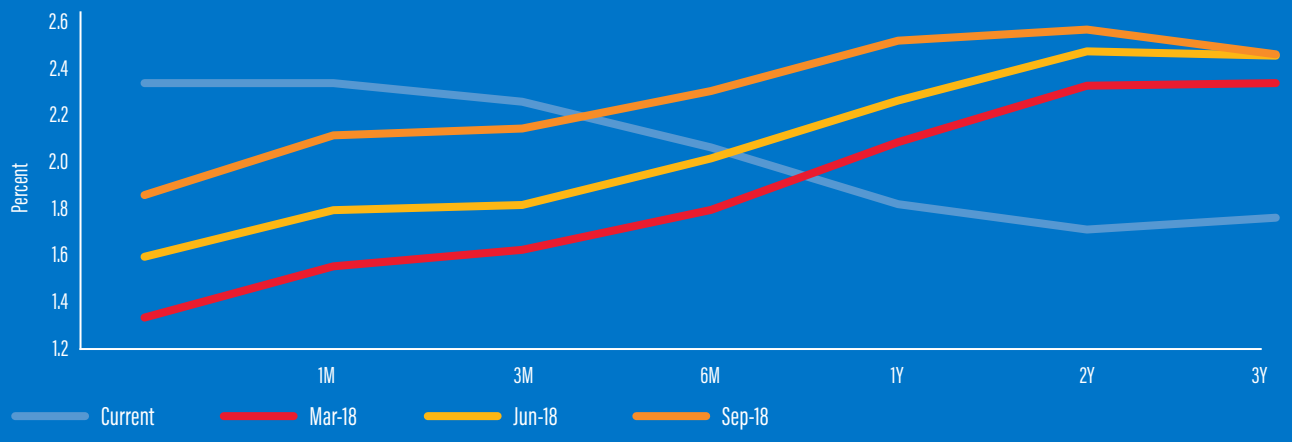
51 Uncertainties include the lack of clarity regarding future trade rules following the deterioration in trade relationships between major countries, the rising support for protectionist policies, the risk of a disorderly Brexit, and a divided political landscape in countries holding general or parliamentary elections.

52 Countries such as Argentina, Brazil, Nigeria, South Africa, and Turkey face emerging market bond index (EMBI) credit spreads above one standard deviation of the 2010-19 average.

53 On June 2019, the European Union agreed to extend their sanctions that target Russia's energy, financial, and defense sectors until the end of January 2020. Meanwhile, Iran continues to face U.S. economic sanctions targeting its oil sector.

54 Yields fell to 10-year lows while the offshore yuan depreciated to its weakest level in 11 years on the day the U.S. government announced additional 10 percent tariffs on US$300 billion worth of Chinese goods. Equity markets in advanced economies in EAP also registered losses due to the trade war escalation.

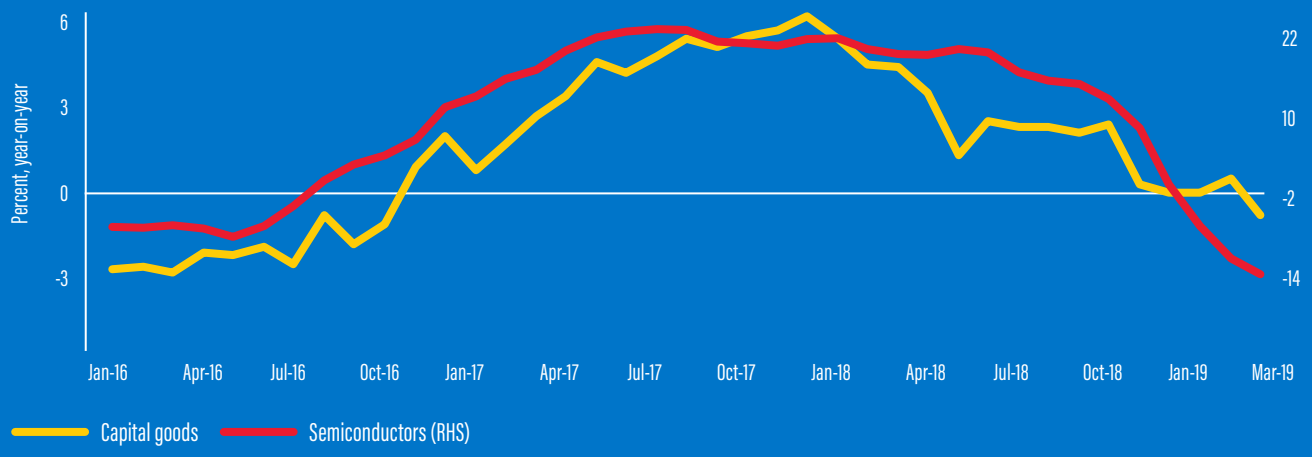
Figure 35.
U.S. Federal Reserve Rate Expectations



Source: Global Economic Prospects June 2019

Global trade is expected to slow substantially in 2019, mainly driven by the re-escalation of trade tensions between the U.S. and China. Global trade growth is expected to decelerate from 4.1 percent in 2018 to 2.6 percent in 2019—the lowest level since the global financial crisis in 2008. Trade tensions between the U.S. and China have recently escalated, with the U.S. announcing additional tariffs on Chinese goods in August 2019.[55] These tensions will likely have a severe economic impact on trade and further contribute to already heighted trade-policy uncertainties that dampen industrial activity. The effects of slowing global trade are most apparent in heavily traded capital goods such as electronic components (e.g., semiconductors), which are deeply embedded in global value chains (Figure 36). While the negative impacts are widespread, affecting the international trading community at large, they are especially felt in China and across Asia. Aside from the U.S.-China trade war, the expected economic slowdown in China and advanced economies will likely weigh on external demand in the rest of the world in the medium term. On the upside, a cyclical recovery in a number of commodity exporters and EMDEs may provide partial offsetting effects, assuming global financial conditions remain accommodative.

Figure 36.
Production of Capital Goods and Semiconductor Sales Growth in the G20



Source: Global Economic Prospects June 2019

55 On August 2019, the U.S. government announced additional tariffs of 10 percent on US$300 billion worth of Chinese imports, on top of the existing 25 percent currently levied on US$250 billion worth of Chinese goods, effectively levying tariffs on all Chinese importation by September 2019. China retaliated by halting the importation of agricultural goods from the U.S., followed by the depreciation of the Chinese Yuan below RMB7.00 per USD for the first time since the 2008 financial crisis.

The global investment outlook remains subdued amid heightened trade and policy uncertainties. Global investment growth is projected to slow from 3.7 percent in 2018 to 2.3 percent in 2019, derailed by escalated trade tensions and policy uncertainties, which have prompted firms to postpone long-term investment plans in both advanced economies and EMDEs.[56] China's economic rebalancing toward a more consumption-driven economy is also expected to contribute to the bleak investment outlook, while export-related investments in other EMDEs will likely ease against the backdrop of a growth slowdown in major economies (e.g., in China, the euro area, and the U.S.) and commodity price weakening in 2019-21. Monetary easing in advanced economies may stimulate some recovery in the short-to-medium term, although elevated government and corporate debt levels in EMDEs may prevent them from taking advantage of cheaper borrowing costs brought about by improved global financial conditions.

Downside risks to the global economic outlook dominate, driven by elevated trade and policy uncertainties, the possibility of a sharper-than-expected slowdown in major economies, and narrow policy space. Trade negotiations between major economies remain fragile and could further deteriorate, resulting in added negative effects on trade and investment. Political uncertainties are heighted, as countries holding general or parliamentary elections in 2019-22 account for 35 percent of global GDP.[57] A sharper economic downturn in the U.S., China, and the euro area (which collectively contribute 50 percent of global GDP) would yield unfavorable spillover effects on other countries, especially EMDEs. In addition, conventional counter-cyclical responses to slow growth are limited, as most advanced economies (except for the U.S.) have near zero, if not negative, interest rates that constrain monetary policy actions, while EMDEs struggle with elevated debt levels that limit space for fiscal stimulus. As such, prudent public investments that prioritize high-impact projects while keeping fiscal balances in check, as well as structural policies that enhance productivity and promote private-sector investments will be crucial in weathering risks.

56 The private sector's 10-year-ahead growth outlook for long-term investments have steadily deteriorated over the past decade, from 6.3 percent in 2010 to 2.7 percent in 2019.

57 Includes countries such as Afghanistan, Argentina, India, Sri Lanka, Philippines, and at least 20 nations in Africa.

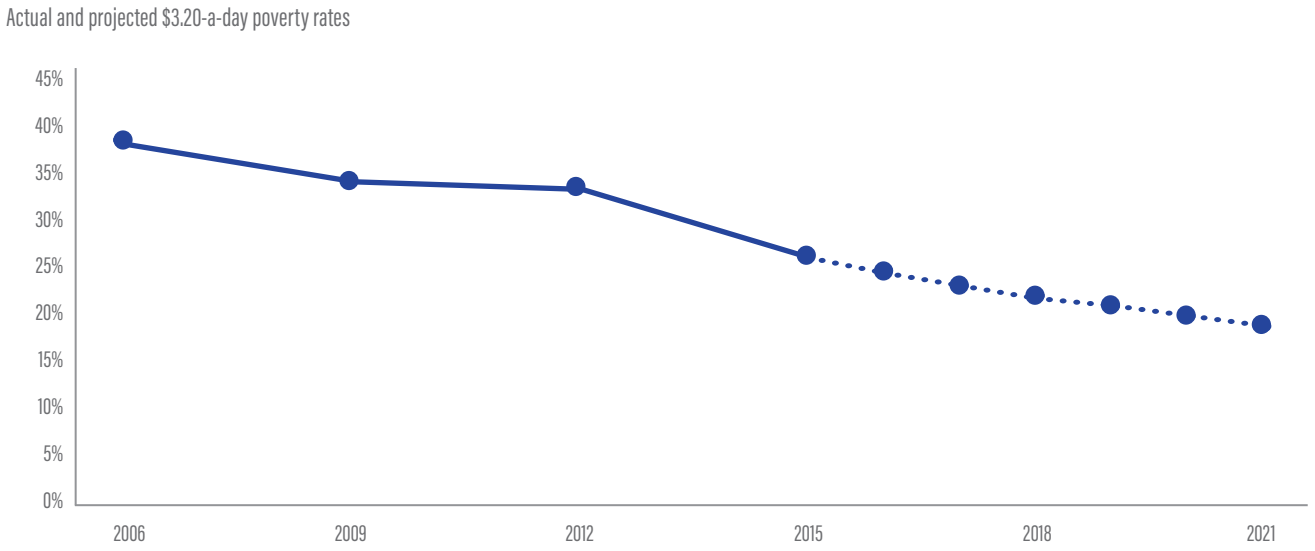
While the industry and agriculture sectors will continue to face challenges, the services sector is set to grow. The industry sector is expected to weaken in 2019 relative to 2018, given weaker performance in the construction and manufacturing sectors. Construction activities were negatively impacted by the slower implementation of public construction projects in the first half of the year, and they will likely be tempered in the second half as the wet season begins. Additionally, manufacturing growth is hampered by the slowdown in global trade and the electronics industry. Foreign direct investments to the sector contracted by 86.0 percent in the first half of 2019 to US$107.0 million—considerably less than US$767.0 million recorded in the same period last year. Meanwhile, the agriculture sector is not expected to significantly recover in 2019, as output in the crops subsector contracted in the first half of the year, mainly due to the El Niño phenomenon. In the medium term, agricultural growth will continue to be hampered by the sector's unresolved productivity challenges and vulnerability to weather-related shocks. By contrast, the outlook for the services sector remains positive, as demand for real estate is expected to continue, fueled by a growing middle class and a steady flow of remittances. Similarly, the demand for financial services is expected to grow, supporting economy-wide growth. The tourism sector is also growing, on track to surpass the number of visitors last year.

CONTINUED PROGRESS ON POVERTY REDUCTION

Despite a temporary economic growth slowdown in the first half of 2019, progress on shared prosperity is likely to continue. Partial estimates from the 2018 Family Income and Expenditure Survey showed that household incomes in lower income deciles grew at a much faster pace than that of the average household, and the continued expansion of non-agriculture wage and salary employment will help sustain recent household income growth. Meanwhile, the government's cash-transfer schemes will continue to help cushion the impact of negative shocks. The enactment of Republic Act 11310, or the Pantawid Pamilyang Pilipino Program (4Ps) Act, on April 17, 2019 guarantees the continuity and sustainability of the 4Ps program, which provides up to Php6,900 (approximately US$130) every two months to compliant households with three children in high school. The 4Ps Act aims to improve the health, nutrition, and education outcomes of children from poor households by providing regular public financial support. Moreover, the country's unconditional cash-transfer (UCT) program provides households with Php2,400 in annual benefits to mitigate the impact of higher excise taxes. In 2018, UCT grants were rolled out to payout modalities of 4Ps and social pension for indigent senior citizens. The UCT program will continue in 2019, with annual benefits increasing to Php3,600.

Similarly, poverty reduction is also expected to continue based on the current economic outlook. Given the continuous expansion of non-agricultural wage employment, the rising real wage, continuation of social programs, and stabilizing inflation, the declining trend in poverty is likely to continue in 2019-21. Medium-term poverty projections based on the middle-income poverty line of $3.20/day show the poverty rate declining from 26 percent in 2015[58] to 20.8 percent in 2019, 19.7 percent in 2020, and 18.7 percent in 2021 (Figure 37).

Figure 37.
Actual and Projected Poverty Rates in the Philippines, 2006-21



Source: PSA, World Bank staff calculation.

58 Actual estimates are slightly different from previous publications due to updates in the Consumer Price Index (CPI).

STEPPING UP DOMESTIC POLICY SUPPORT AMID INTENSIFIED EXTERNAL RISKS

External risks have intensified, marked by a slowdown in global growth and demand. Domestic risks include slower-than-expected growth in public investment spending and prolonged uncertainty surrounding the passage of the remaining reform program. Prudent public expenditure and investment management is needed as the government pursues its expansionary fiscal agenda. Pursuing structural reforms and following through on the implementation of recently passed reforms will help strengthen market confidence.

External risks have intensified while the threat of capital outflows has abated. The Philippines faces heightened external risks due to the slowdown in global growth and demand, weaker global manufacturing activity, and rising global protectionism[59]. The unresolved trade dispute between the U.S. and China, coupled with a newly emerged trade conflict between Japan and Korea, strains the regional value chain that the Philippines is a part of. This darkens the prospect of the country's export performance, which has already been reeling from the decline in electronics export growth due to the downturn in the electronics production cycle. While the likelihood of intensified capital outflows has subsided, given the more dovish stance of central banks in advanced economies, episodes of abrupt volatility in the financial market remain a possibility, driven by the re-escalation of trade wars and geopolitical disturbances.

A slow recovery in public investments constitutes the main domestic downward risk. While some domestic risks have subsided, including the threat of high inflation, accelerating the roll-out of public investments would be crucial to achieve the baseline growth outlook. The need to judiciously expedite public expenditures, which have fallen short of their desired target so far for the year, is not only important to increase economic growth but also to addresses the country's physical infrastructure and human capital needs. In particular, several national government agencies continue to face implementation bottlenecks which have prevented line agencies from fully executing their budgets, with issues relating to absorptive capacity, procurement difficulties, and right-of-way issues.[60] In the long-term, addressing capacity constraints at the LGU level will play a more important role, as LGUs are expected to receive a larger share of national government transfers in 2022 as a result of the recent Supreme Court ruling which increases the share LGUs receive from national government taxes (Box 5). Moreover, ensuring the timely passage of the 2020 budget will be critical to continue the public investment momentum. Other domestic risks include the prolonged uncertainty surrounding the passage of the corporate income tax bill, which has tempered private investment growth since 2018.

59 Rising global protectionism is a risk to global growth and trade at large, which translates to the risks of weak external demand to the Philippines

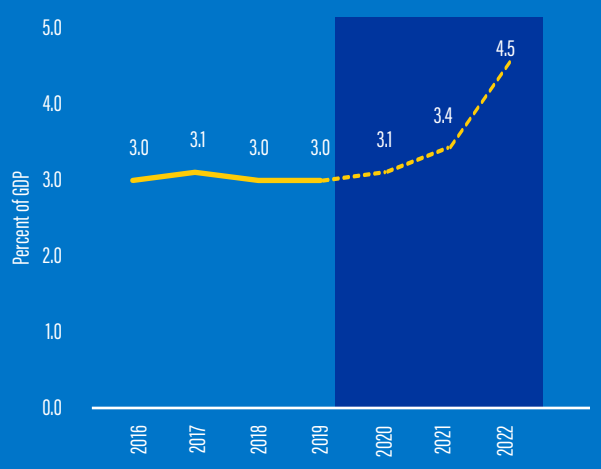
60 For example, according to audit reports by the Commission on Audit, DOTr and DPWH, disbursed only 20.6 percent and 39.2 percent of their budgets in 2018. Both the DOTr and the DPWH will continue to play an integral role in the government's infrastructure investment program, and addressing these implementation bottlenecks, which have plagued line agencies for years is crucial in order to ensure that the pace of the public investment program ramps up over the medium-term.

Box 5.
The Mandanas Ruling

Earlier this year, the Supreme Court finalized its ruling which grants LGUs a larger portion of the taxes collected by the national government, starting in 2022. On January 2012, former Batangas 2nd District Representative Hermilando Mandanas filed a petition to the Supreme Court, arguing that the Internal Revenue Allotment (IRA) – the share of national government tax collections provided to LGUs – should be equal to 40 percent of the revenues of both the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC), as opposed to the current scheme which is based on BIR collections only. On April 2019, the Supreme Court rendered final its decision in agreement with Mandanas and specifically mandated the corresponding increase in the IRA to begin during the 2022 budget cycle.

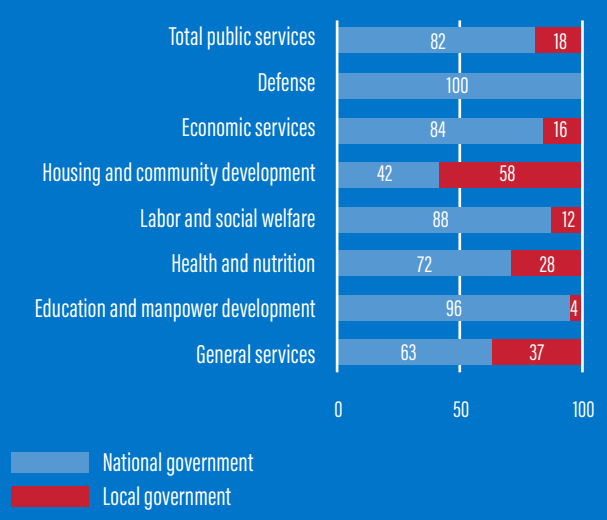
The Mandanas ruling will significantly increase local government resources to deliver public service. Under the current scheme, LGUs have been receiving around 3.0 percent of GDP annually from the IRA transfers, constituting some two thirds of local government revenue sources. IRA transfers are estimated to reach about 4.5 percent of GDP by 2022 (Figure 38) due to the implementation of the Mandanas Ruling – significantly augmenting LGU budgets, especially those of non-city government units which have less capacity to generate tax revenues from local sources.[61] As a result, LGUs will be expected to play a larger role in the delivery of public services. Currently, the national government is responsible for 82 percent of public service spending (Figure 39).

Figure 38.
Projected IRA increase as a result of the Mandanas Ruling



Source: : DBM, BTr, World Bank Staff calculations

Figure 39.
NG and LGU contributions to public expenditures per sector in 2018 (%)



Note: Due to data constraints, LGU capital outlays were assumed to be spent on economic services while barangay expenditures were assumed to be purely based on their IRA shares and follow the same distribution across sectors as provinces, cities, and municipalities.

Source: DBM, BLGF, WB staff estimates.

61 City governments are less reliant on the IRA for as they are able to generate significant revenues from local taxes, due to the higher levels of economic activity and real estate valuations in their jurisdictions.

Meanwhile, the passage of investment-friendly reforms would improve the country's growth outlook. Passing investment-friendly reforms such as the Public Service Act amendment, which would lift foreign ownership limits in key sectors including in telecommunication and transportation services, and the Retail Trade Liberalization Act, which would reduce the required minimum paid-up capital for foreign entrants in the retail sector, would contribute to higher levels of FDI. Evidence shows that higher FDI helps to boost local productivity, therefore the timely passage of investment friendly reforms serves as an upside risk to growth.

In addition, accelerating the implementation high-impact flagship projects would be critical in expanding Philippine's growth potential in the medium term. So far, only 11 out of the 75 flagship projects have reached the construction phase after three years into the administration and only 25 are expected by the government to be completed before 2022. Actual obligations data suggest the recent ramp-up in infrastructure spending financed smaller-scale public works, government-owned and controlled corporations (GOCCs) projects, and increases in defense spending (Box 6). Anecdotal evidence suggests that these smaller scale projects do not undergo the same scrutiny as the larger scale infrastructure projects identified in the Build, Build, Build program, and might thus provide less value-for-money to the government and the economy as their economy wide productivity-enhancing effects are likely to be smaller than the flagship projects', while still costing large sums that put pressure on fiscal and current account balances.[62] As such, hastening the implementation of the higher-impact 75 flagship projects will be key to optimizing the returns of public infrastructure investment, efficiently closing the infrastructure gap, and expanding the Philippine economy's long-term growth potential.

62 For example, some smaller scale road projects in the Philippines were implemented without going through proper scrutiny resulting in incomplete projects, while costing the government valuable resources. Source: https://opinion.inquirer.net/114494/infra-spending-goes-nowhere.

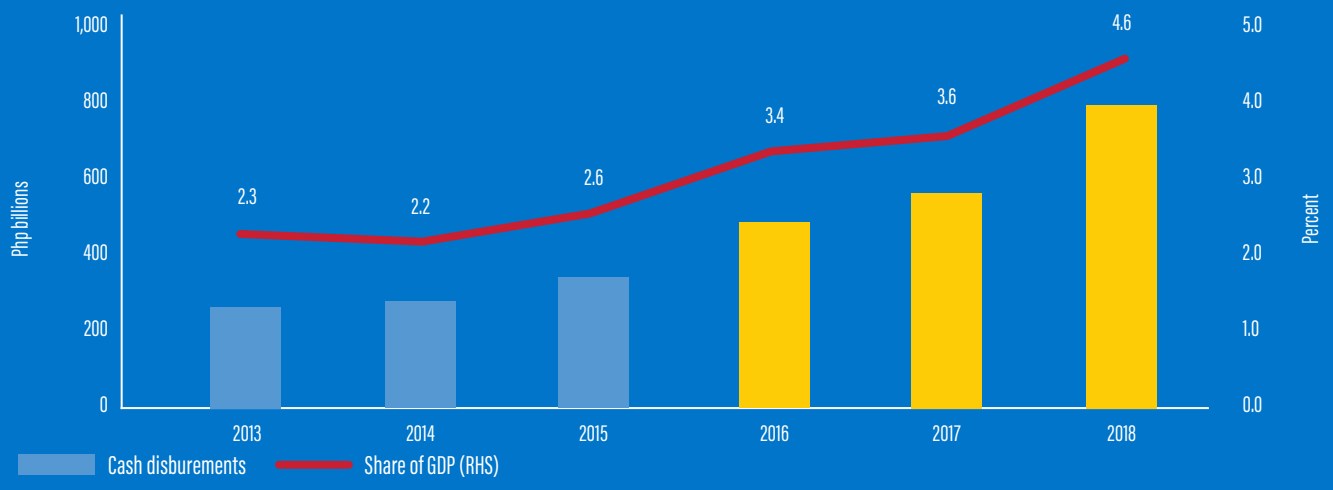
Box 6.
Infrastructure Spending

The government has ramped up infrastructure spending despite delays in the implementation of flagship projects. Infrastructure cash outlays have been steadily increasing from an average of 2.4 percent of GDP in the three years preceding 2016, to 4.6 percent of GDP in 2018 (Figure 38). Most notably, infrastructure spending rose sharply by 41.2 percent in 2018, and is expected by the government to breach 6 percent GDP by 2021, as it continues to pursue its Build, Build, Build agenda.[63] However, these expenditures have not been used for the highest-impact investments, as the implementation of government's 75 flagship projects has been slow, with only 11 projects reaching the construction phase as of April 2019. According to the National Economic Development Authority (NEDA), only 25 projects with investment costs amounting to Php263.2 billion are expected to be completed before 2022, while the remaining 50 projects worth some Php1.9 trillion may still commence implementation during the administration.

Public works account for most of infrastructure obligations made during the first three years of the administration. DPWH accounted for 73.0 percent of the infrastructure budget, a significant increase from its average share during the last three years of the previous administration (55.3 percent). Obligations for road projects almost doubled from an average of 1.1 percent of GDP per year between 2013-15, to 2.0 percent of GDP in 2016-18, accounting for the largest share of the infrastructure outlays (42.5 percent). These have resulted in faster expansion the national road network and improvement in road quality.[64] Flood control systems (13.1 percent) and school buildings (11.8) are the next largest infrastructure priorities, with their allocations increasing by three and six times, respectively, as a percentage of GDP. The Department of Transportation's (DOTr) participation (4.5 percent) in infrastructure spending improved slightly during the past three years, although still lagging significantly behind DPWH despite also being a lead implementing agency for the Build, Build, Build program.

GOCCs are key drivers in rolling out the government's infrastructure plan. Infrastructure obligations of the GOCC sector in the first half of the Duterte administration matched the levels during the last half of the previous government at 0.4 percent of GDP, although significantly declining as share of the total infrastructure budget. These were led by the irrigation system projects of the National Irrigation Administration (NIA) which averaged at 0.2 percent of GDP per year in 2016-18, double compared to its obligations in 2013-15, followed by the projects of the various

Figure 40.
Infrastructure Capital Outlays



Source: DBM.

63 National Government Fiscal Program, 2017-2021

64 The total length of national roads grew by an average of 2.1 percent per year between 2016-18, a significant improvement from the -0.1 percent average in 2010-15. Road conditions also improved, with paved roads accounting for 96 percent of the total national road length by 2018, increasing significantly from 88.4 percent in 2015. Data from DPWH infrastructure statistics.

housing authorities (0.1 percent of GDP). However, the share of the infrastructure program allocated to GOCCs has been halved from 15.6 percent of infrastructure budget in 2013-15 to only 7.9 percent in 2016-18 as increases in the budgets of certain national government agencies (e.g. DPWH, DND, and DOTr) were prioritized.

Defense infrastructure spending increased considerably in the past three years. DND infrastructure obligations more than quadrupled from an average of 0.03 percent of GDP per year in 2013-15 to 0.12 percent of GDP per year in 2016-18. The sharp increase was mostly driven by spending on machinery and equipment which accounted for 85 percent of the DND's infrastructure spending during the past three years. As a result, the share of defense infrastructure spending almost doubled from 1.2 percent to 2.3 percent, nearly matching the Department of Health's (DOH) share of the infrastructure budget (2.5 percent) which is mostly spent on hospitals and health centers.

Table 5.
Breakdown of Actual Obligated Infrastructure Outlays, 2016 and 2017

	Percent of GDP		% Share of infra budget	
	2013-15	2016-18	2013-15	2016-18
DPWH	**1.5**	**3.5**	**55.3**	**73.0**
Road networks	1.1	2.0	41.4	42.5
Flood control systems	0.2	0.6	8.0	13.1
School buildings	0.1	0.6	3.5	11.8
Others	0.1	0.3	2.4	5.6
Budget support to GOCCs	**0.4**	**0.4**	**15.6**	**7.9**
Irrigation systems (NIA)	0.1	0.2	2.0	3.7
Housing-related infrastructure assets (NHMFC, NHA, SHFC)	0.2	0.1	8.6	2.8
Others	0.1	0.1	5.1	1.4
DOTr	**0.1**	**0.2**	**4.0**	**4.5**
Airport systems	0.0	0.1	1.7	1.9
Seaport systems	0.0	0.0	0.3	0.2
Others	0.1	0.1	2.1	2.3
DOH	**0.1**	**0.1**	**2.4**	**2.5**
Hospital and health centers	0.1	0.1	2.3	2.3
Others	0.0	0.0	0.0	0.2
DND	**0.0**	**0.1**	**1.2**	2.3
Machinery and equipment	0.0	0.1	1.2	1.9
Others	0.0	0.0	0.0	0.3
Other NG agencies	**0.6**	**0.5**	**21.5**	**9.8**
Total NG infrastructure outlays	**2.7**	**4.7**	**100**	**100**

Source: DBM

Although the country's debt metrics and fiscal balance remain favorable, prudent management of public expenditure is needed to ensure long-term fiscal sustainability. The Philippines' investment outlook is anchored on the successful implementation of the government's infrastructure program. By 2021, government disbursements are set to increase by an estimated 142.4 percent in nominal terms since 2014, with infrastructure spending increasing by nearly five-times over the same period. As the government continues to ramp-up spending, evaluating the quality of public expenditure is important to ensure that resources are spent effectively and efficiently which requires ensuring that all remaining challenges to implementation and budget execution are addressed.

The successful and timely passage of the remaining packages of the government's comprehensive tax reform program is needed to ensure the health of the country's long-term fiscal balances (Box 7). The remaining packages are part of the government's medium-term fiscal program and have been filed in the House of Representatives under the 19th Congress of the Philippines. However, a number of these proposed tax reform packages have met stiff resistance in the legislative branch such as mining taxation, and corporate tax regime reform which are more challenging politically. As the administration enters the second half of its term, ensuring that the reform momentum is sustained is crucial towards locking in the recent successes in fiscal policy made. Their successful passage would ensure that the government is able to keep its deficit within its programmed target. Moreover, the swift passage of the corporate tax reform will be important to temper uncertainties on the private sector, as the delay has already had an impact on the pace of private investment growth.

Judiciously using the regained monetary space and foreign reserves can help support growth and buffer external shocks. Heightened global uncertainty, strong capital outflows, and rising domestic inflation in 2018 eroded the country's international reserves and chipped away monetary policy space. The Philippines' market conditions, however, have become more benign since the beginning of 2019, marked by a sustained decline in domestic inflationary pressure and favorably influenced by the more dovish stance by the U.S. Federal Reserve. With capital flowing back to emerging markets like the Philippines, the country's foreign exchange rate has strengthened, and international reserves have increased from US$77.5 billion in June 2018 to US$85.4 billion in June 2019. Maintaining the flexibility of the exchange rate regime and ensuring ample foreign exchange reserves will help the country buffer terms-of-trade shocks at a time of re-escalating trade tensions. Additionally, inflation has declined and expected to fall, on average, to within the BSP's 2-4 percent target range in 2019. This will enable the BSP to maneuver its key policy rate to help address weakened economic growth prospects.

Box 7.
The CITIRA Bill and the Government's Comprehensive Tax Reform Program

The government's efforts to implement its comprehensive tax reform program continues in the 18th Congress of the Philippines with corporate income tax (CIT) and incentives reforms. The Philippine government was able to pass the previous version of the proposed Corporate Income Tax and Incentive Rationalization Act (CITIRA) – then known as the Tax Reform for Attracting Better and High-Quality Opportunities (TRABAHO) bill – in the House of Representatives under the 17th Congress of the Philippines but was unable to move forward in the Senate. President Duterte urged members of the Congress to pass the CITIRA bill during his fourth State of the Nation Address.

The proposed bill aims to improve the Philippines' competitiveness by improving the fairness, efficiency, and equity of the country's tax system. The bill (Package 2) aims to improve the Philippines' competitiveness on a global scale by gradually reducing the CIT rate from 30 percent, which is among the highest in ASEAN, to 20 percent over the course of ten years. Lowering the CIT gradually to reach 20 percent will make the Philippines' rate among the lowest in the region, which will contribute toward attracting more foreign and local investment. There are currently fourteen government agencies granting tax incentives with discretion and over 300 special laws that create incentives for firms to arbitrage. The proposed bill also aims to reduce leakages and distortions by simplifying and unifying the country's tax incentive regime. The Department of Finance estimated Php441.1 billion in tax incentives in 2017, benefitting around 3,000 companies. The government aims to modernize the country's incentive system to ensure that fiscal incentives are performance-based, targeted, time-bound, and more transparent. The proposed incentive regime requires that firms that want to benefit from fiscal incentives invest in industries that are aligned with the Philippines' development agenda, help spur investment growth in lagging regions, and encourage the accumulation of human capital through worker upskilling and training.

While the approval of the government's proposed reforms will help create a more competitive business environment in the long term, ensuring a smooth transition in the short term is crucial to maintain business confidence. International experience demonstrates that corporate tax reforms are complex, and governments often face strong opposition when implementing reforms, as changes usually involve winners and losers. Countries that have successfully managed to introduce tax reforms tend to pay special attention to clearly communicating the process and content of the reform, as well as carefully

setting up an implementation plan. In the case of the Philippines, it is essential that the government continuously communicates the progress and details of the proposed reform to reduce uncertainties within the business community. In addition, to achieve the goal of simplifying and making tax incentives more transparent and improve governance, the government should create a set of clearly defined implementing regulations to reduce discretion by implementing agencies and regulators.

All other proposed tax reform bills have been filed in the 18th Congress of the Philippines. The remaining tax reform packages have been filed in the House of Representatives. In particular, Package 1C aims to hike the motor vehicle user's charge in order to finance the government's various infrastructure projects. Meanwhile, Package 2-plus seeks to introduce adjustments to sin taxes, particularly on alcohol products, which will help finance the government's universal health care program. Package 3 aims to reform the country's property valuation system by improving the quality of valuations by local governments. The government aims to do this by increasing the frequency of revisions and making the process more efficient, transparent, and reflective of the latest market developments. Lastly, Package 4 aims to make taxation of passive income and financial taxes simpler, fairer, more efficient, and more competitive by unifying tax rates on passive income, reducing the number of final withholding tax rates, and harmonizing business taxes on financial intermediaries, among others.

In the short term, fast tracking implementation of recently approved game-changing reforms would help to achieve inclusive growth. As part of the 10-point socioeconomic agenda of the government, various game changing reforms have been passed in 2018 such as the Ease of Doing Business Law,[65] the Rice Tariffication Law, the creation of a foundational ID, the National Payment System Act, the cash budgeting, among others, are transformational policy changes that have the potential to accelerate inclusive growth. However, progress on the implementation of these reform has been slow. For instance, it took about a year for the implementing rules and regulations (IRR) of the Ease of Doing Business law to be released, while the IRR for the National Payment Systems Act has yet to be finished. Meanwhile, a proposal for new price-control measures through the implementation of a suggested retail price (SRP) on rice may dilute the ability of the Rice Modernization law to lower prices. In addition, the timely and effective implementation of the Rice Competitiveness Enhancement Fund is crucial to protect farmers during the transition period from the quota to tariff system on rice and help them increase rice productivity, diversify to high-yield crops and sustain progress on poverty reduction. Therefore, fast tracking the effective implementation of these game-changing reforms would be critical to set the country to a higher path toward inclusive growth.

In the long term, promoting competition to foster quality job creation will enhance the impact of economic growth on poverty reduction and shared prosperity. The lack of competition in key sectors remains as one of the key binding constraints towards achieving a more inclusive growth path – the type that creates more and better jobs and reduces poverty. Unequal and discretionary application of policies and overly-restrictive regulations weaken market competition in sectors critical for firms to enter and thrive. Making markets more open to competition will help guide labor towards more productive employment. This can be achieved through two channels: first, the improvement in firm-level productivity, and second, the labor re-allocation to more productive firms within an industry. Through firm entry and exit, competition encourages the disappearance of low-productivity jobs and the creation of more productive jobs, along with the reduction in "labor hoarding" for firms that previously enjoyed strong market power. Productive firms, in a bid to stay ahead of competition, tend to invest in education, training, and skills development for workers to keep them apace in the changing work environment. The delivery of quality jobs and human capital is especially relevant for the Philippines where an above 6 percent average growth since 2010, has not fully translated into faster poverty reduction and shared prosperity. Hence, a robust competition policy that leads to quality job creation will help increase the growth impact on poverty and inequality.

Structural reforms that aim to reduce regulatory restrictiveness in key markets and encourage market competition should be prioritized to strengthen private-sector development. Evidence suggests that removing the restrictiveness of regulations in selected sectors has a positive effect on value added, productivity, and export growth beyond these sectors. Estimates for the Philippines reveal that the removal of restrictive product market regulations in the professional services, energy, and transport sectors would increase economic growth by an additional US$0.6 billion, or lead to an increase of 0.2 percentage point in the annual GDP growth rate in sectors that use these services intensively.[66] Reducing regulatory restrictiveness require, among others, implementing a number of reforms aimed at eliminating restrictions on foreign as well as domestic investors in sectors where such restrictions create an uneven playing field; minimizing the scope of controlled prices to incentivize firms to compete; and streamlining burdensome administrative procedures for businesses in order to facilitate easy market entry. (See Part III: Special Focus Note on Competition).

65 The "Ease of Doing Business Law" strengthens the "Anti-Red Tape Law" which aims to cut down processing time for government permits, transactions, and applications. It aims to reduce the cost of doing business in the Philippines, and limit bureaucratic red tape, from government institutions.

66 World Bank (2018), "Fostering Competition in the Philippines: The Challenge of Restrictive Regulations," Washington DC: World Bank.

03

FOSTERING COMPETITION IN THE PHILIPPINES: THE CHALLENGE OF RESTRICTIVE REGULATIONS

Compared to regional peers, Philippine markets are relatively more concentrated, with a higher proportion of monopoly, duopoly, and oligopoly markets. This has translated into relatively poor service delivery for Filipino firms and higher prices for goods and services paid by households and firms compared to other countries. Furthermore, limited competition in key economic sectors has been consistently identified as a constraint to the creation of more and better jobs and faster poverty alleviation. Unequal and discretionary application of policies and overly-restrictive regulations weaken market competition in sectors critical for firms to enter and thrive. These restrictions are linked to the participation of the state in key markets, including state ownership and involvement in business operations of SOEs; the existence of barriers to entry and rivalry, such as complex regulatory procedures and administrative burdens on start-up businesses; and barriers to trade and investments, including foreign equity investments. Reducing restrictions to market competition would yield significant payoffs for households and firms in the Philippines and boost the economy's overall competitiveness.

Philippine markets are concentrated limiting market competition in key sectors

Markets in the Philippines are relatively concentrated, limiting competition in key sectors. Philippine manufacturing markets appear to be more concentrated than those of regional peers,[67] with a higher (Figure 41) and increasing (Figure 42) proportion of monopoly, duopoly, and oligopoly markets. Moreover, close to 50 percent of markets in the wholesale/retail sector, more than 70 percent in agriculture, and more than 95 percent in transport/storage[68] could be classified as highly concentrated, according to standard Herfindahl–Hirschman Index (HHI)[69] thresholds used by competition agencies.[70]

Another measure for degree of competition in a market is the price cost margin (PCM)[71], which in a competitive setting, should move towards a value of zero as firms adjust their prices downwards. In the Philippines, more than 70 percent of agricultural markets, 60 percent of manufacturing markets, 80 percent of wholesale/retail markets, and 90 percent of transport/storage markets have an average PCM of more than 40 percent, suggesting the existence of market power by firms. In some cases, such outcomes can be facilitated by market rules and regulations such as price controls.

67 Regional peers were selected among those countries with available information from the World Bank's Enterprise Survey.

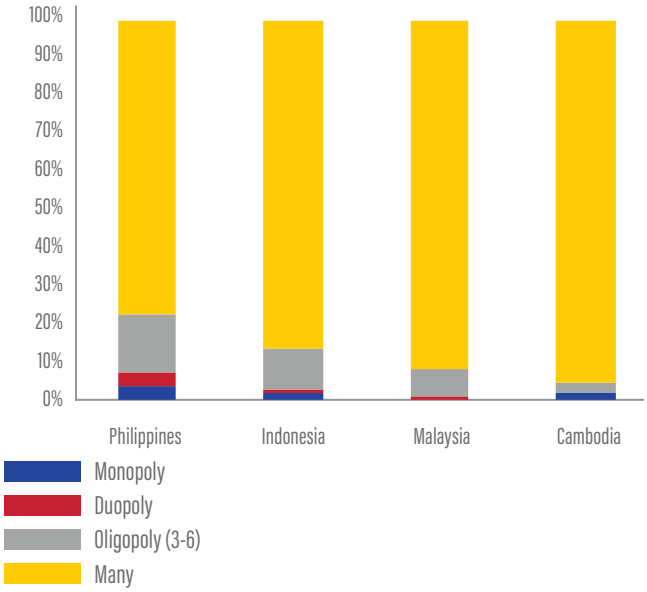
68 While transport and storage markets tend to be highly concentrated, given their market characteristics, (and accordingly these markets are often subject to regulation), concentration levels in the Philippines appear to be relatively high even in transport and storage markets where competition should be viable such as local bus, cargo handling, and freight forwarding services.

69 The HHI takes into account the relative size distribution of the firms in a market. It approaches zero when a market is occupied by a large number of firms of relatively equal size and reaches its maximum of 10,000 points when a market is controlled by a single firm. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. Source: https://www.justice.gov/atr/herfindahl-hirschman-index

70 Data source: 2012 Census of Philippine Business and Industry (CPBI), a nationwide census conducted by the Philippine Statistics Authority. The statistics are only based on data from the formal sector of the economy, including corporations and partnerships, cooperatives and foundations, single establishment with ten or more employees, and single proprietorship with branches. The initial count of the 2012 List of Establishments (LE), the frame used to draw the sample establishments for the 2012 CPBI, registered a total of 945,000 establishments in operation nationwide in 2012. Out of this, 680,400 establishments, 72 percent, belong to the informal sector and only 262,800 establishments, or 28 percent, made up the formal sector. Source: Philippine Statistics Authority.

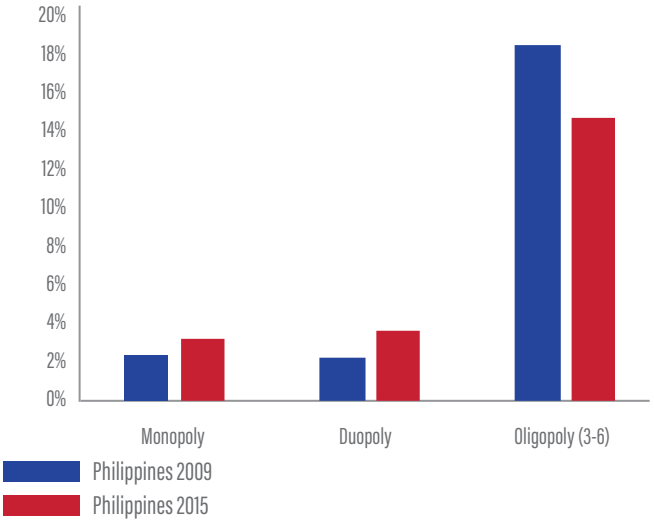
71 The PCMs are calculated by considering the firm's direct costs of sales and labor costs as the firm's total variable costs. The PCM for each firm is obtained by first, getting the difference between the firm's total sales (revenue from its main activity plus sales of its products/by-products) less the firm's total variable costs from the firm's total sales, and then the ratio of this difference and the firm's total sales. The average PCM per market is estimated from the firm-level PCMs.

Figure 41.
Market Concentration in Manufacturing in the Philippines and Selected EAP Countries



Source: World Bank's Enterprise Survey, 2009 and 2015.

Figure 42.
Evolution of Market Concentration in Manufacturing in the Philippines



Source: World Bank's Enterprise Survey, 2009 and 2015.

High concentration in markets with low natural barriers to entry further suggest lack of competition in many sectors due to market rules and regulations. In environments where competition would usually be considered viable, there are a number of markets in the Philippines with only one formal sector firm in operation.[72] In agriculture, there are 15 national markets that have only one firm operating, 16 in manufacturing, 5 in wholesale/retail, and 15 in transport/storage (Table 6). With the exception of a small number of transport markets where monopolies are more common (such as railway transport and postal activities), competition would typically be considered viable in the majority of these single-firm markets. Figure 43 through Figure 46 show the HHI and PCMs for markets that are in the top decile of both distributions. Even in the transport/storage sector, which tends to be more naturally prone to concentration, the markets captured here are those which would usually be considered contestable – including road freight transport, grain warehousing, and inland freight water transport. Markets with high concentration and PCMs may indicate that market rules and regulations hinder competition.

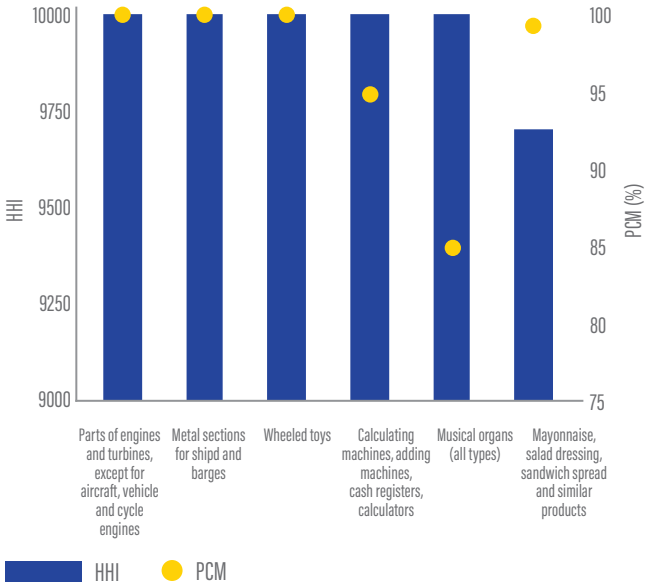
Table 6.
Number of National Markets with Only One Firm Operating by Sector

Sector	Number of markets with only one firm operating
Agriculture	15
Manufacturing	16
Transport/storage	15
Wholesale/retail	5

Source: WBG Markets and Competition Policy team calculations based on Census 2012 of the Philippines Business and Industry

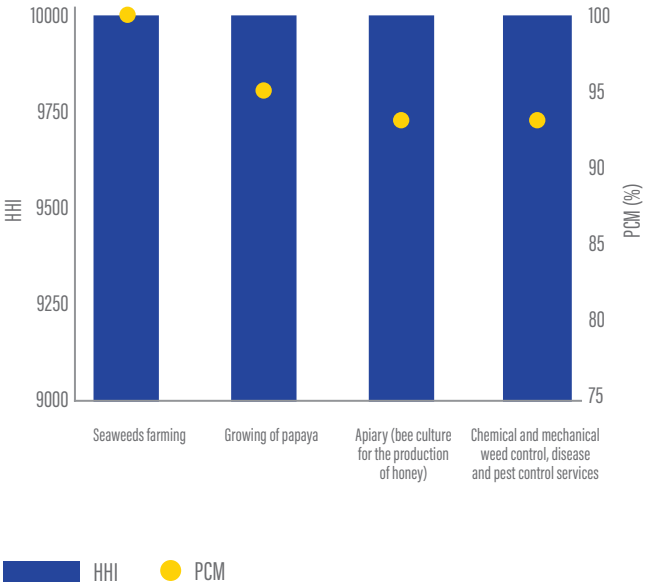
72 This does not take into account the existence of informal firms.

Figure 43.
Manufacturing Markets in the Top Deciles of HHI and PCM Distributions



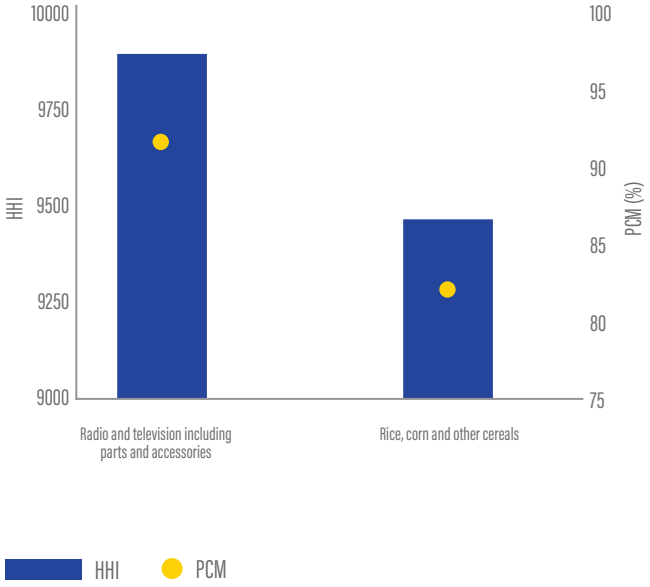
Source: WBG Markets and Competition Policy team calculations based on Census 2012 of the Philippines Business and Industry

Figure 44.
Agricultural Markets in the Top Deciles of HHI and PCM Distributions



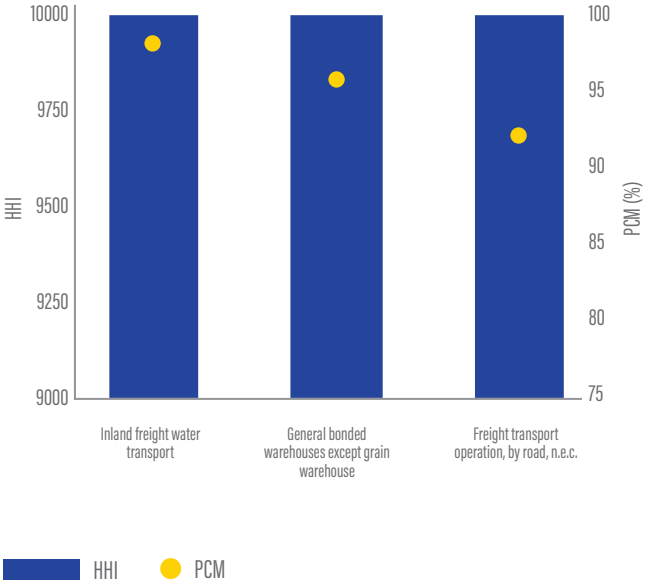
Source: WBG Markets and Competition Policy team calculations based on Census 2012 of the Philippines Business and Industry

Figure 45.
Wholesale/retail markets in the Top Deciles of HHI and PCM distributions



Source: WBG Markets and Competition Policy team calculations based on Census 2012 of the Philippines Business and Industry

Figure 46.
Transport/storage markets in the Top Deciles of HHI and PCM distributions

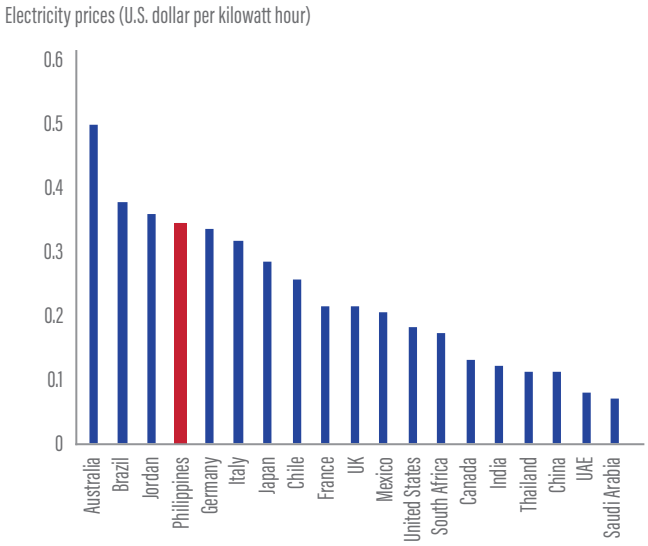


Source: WBG Markets and Competition Policy team calculations based on Census 2012 of the Philippines Business and Industry

The lack of competition in key sectors has negatively impacted Philippine firms and consumers

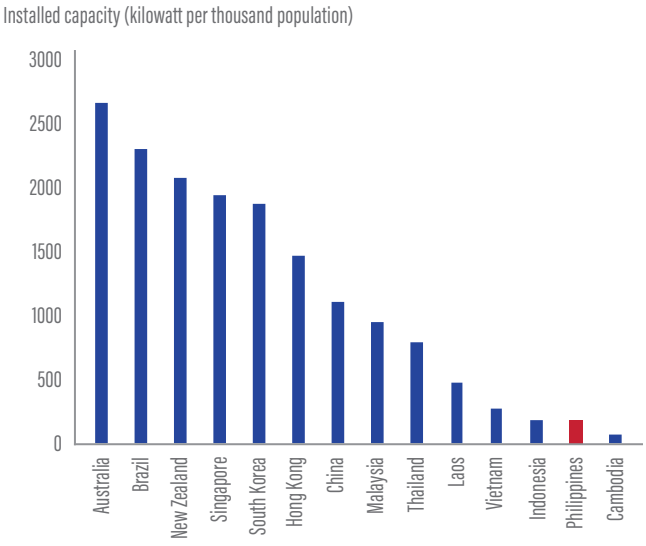
While the Philippines' electricity sector has undergone significant changes in recent years due to a new regulatory framework, the implementation of key reforms is still pending. The Electric Power Industry Reform Act (EPIRA) of 2001 fully restructured the sector's legal and institutional framework. However, there are concerns regarding the speed of implementing the reforms mandated by EPIRA, especially related to complying with the Energy Regulatory Commission's (ERC) provisions for open access and competition in retail as well as the separation of different market segments. The ERC recently ordered the separation of operators in distribution and supply markets to foster competition in retail,[73] but this decision was appealed before the Supreme Court.[74] Unbundling concerns and the overall limitation on FDI in utilities, which prevents the development of much needed electricity infrastructure, have resulted in limited capacity and high prices in the Philippines compared with regional peers (Figure 47 and Figure 48).

Figure 47.
The Philippine electricity sector is associated with relatively higher electricity prices...



Source: Electricity prices by country in 2015 https://www.statista.com/statistics/477995/global-prices-of-electricity-by-select-country

Figure 48.
...and limited capacity compared to regional peers.



Source: Installed capacity, CIA World Factbook; Population, World Bank Development Indicators

73 The Retail Competition and Open Access was established by the Department of Energy Circular DC 2015-06-0010 and Resolutions 10 and 11 (year 2016).

74 The Supreme Court-issued temporary restraining order (TRO) remains unresolved as of May 2019. https://www.bworldonline.com/erc-studying-way-forward-with-licenses-expiring-amid-supreme-court-tro/

In the telecommunications sector, the National Telecommunications Commission's (NTC) lack of regulatory power to foster competitive market conditions has resulted in suboptimal market outcomes. The price of mobile phone services in the Philippines is among the highest in the region and four times higher than average of Organisation for Economic Co-operation and Development (OECD) countries. The NTC's limited regulatory capacity has prevented it from implementing important pro-competition reforms, such as unbundling of the local loop. Ownership is highly concentrated between two companies, which is largely due to FDI restrictions. Such restrictions have not only insulated Philippine telecoms from foreign competition but also restricted investment in infrastructure, which has likely perpetuated market concentration.

Regulatory restrictions in the transport sector appear to impair logistics in the Philippines. Road transport accounts for 58 percent of the country's cargo traffic.[75] While road cargo is characterized by a large number of small firms providing basic transportation services, there are several regulatory restrictions, mainly related to entry barriers. Trucking companies need to acquire licenses to operate in the market, which requires them to interact with eight government agencies.[76] Philippine citizenship and hauling contracts are also required to establish a business in national road freight services.[77] Moreover, participation of foreign firms in public transport tenders is restricted to cases where (1) a treaty or executive agreement allows them to participate; (2) reciprocity rights exist; and (3) goods are not available locally.[78]

Concentrated market structures in domestic shipping contribute to relatively higher shipping costs in the Philippines. The average port-to-port cost per nautical mile in the Philippines is US$1.47—higher than Indonesia's US$0.77 and Malaysia's US$1.36. Barriers to market competition appear to be among the causes of the poor state of the domestic shipping industry. Few operators serve most shipping routes, with more than 40 percent of routes served by a single operator. While some market concentration is likely due to market factors, such as economies of scale in shipping operations, the threat of potential entry of competitors is often the major force driving market behavior in the industry. Moreover, prior to 2015, incumbents had to give their consent for new entry in the routes they were serving.[79]

Professional service providers in the Philippines face regulatory restrictions that may reduce their incentives to offer high-quality services at competitive prices. Burdensome accreditation requirements apply across regulated professions. Advertising is restricted for accountants, architects, and engineers, even though the ability of firms to advertise can help improve service quality and overcome the information asymmetries inherent in the professional services industry. There are also pricing guidelines for lawyers, engineers, and architects. Since the market effects of these practices are similar to those of cartel agreements, competition policy reforms in professional services have been consistently targeted by policymakers across countries as a way to accelerate economic growth by boosting productivity without affecting service quality or professional standards.

75 Asian Development Bank 2012, *Philippines: Transport Sector Assessment, Strategy, and Road Map*, Mandaluyong City, Philippines, p. 1.

76 License involves applications to: the Land Transportation Franchising and Regulatory Board (LTFRB), the Department of Transportation (DOTr), the Department of Trade and Industry (DTI), the Land Transportation Office (LTO), the Bureau of Internal Revenue (BIR), the Local Government Unit of Principal Address of the Corporation or Partnership, the SEC, and the Barangay of the Principal Address of the Corporation or Partnership.

77 See the information on the Land Transportation Franchising and Regulatory Board, available at http://www.ltfrb.gov.ph/media/Truck_FAQs.pdf

78 See Section 5.2 of Procurement of Goods, http://www.dotc.gov.ph/images/Public_Bidding/Goods/2015/road/LTODriversLicenseCards/BidDocs_LTO-DLC_Final.pdf

79 See the WBG Trade & Competitiveness Project Brief "Paving the Way for Competitive Domestic Shipping in the Philippines."

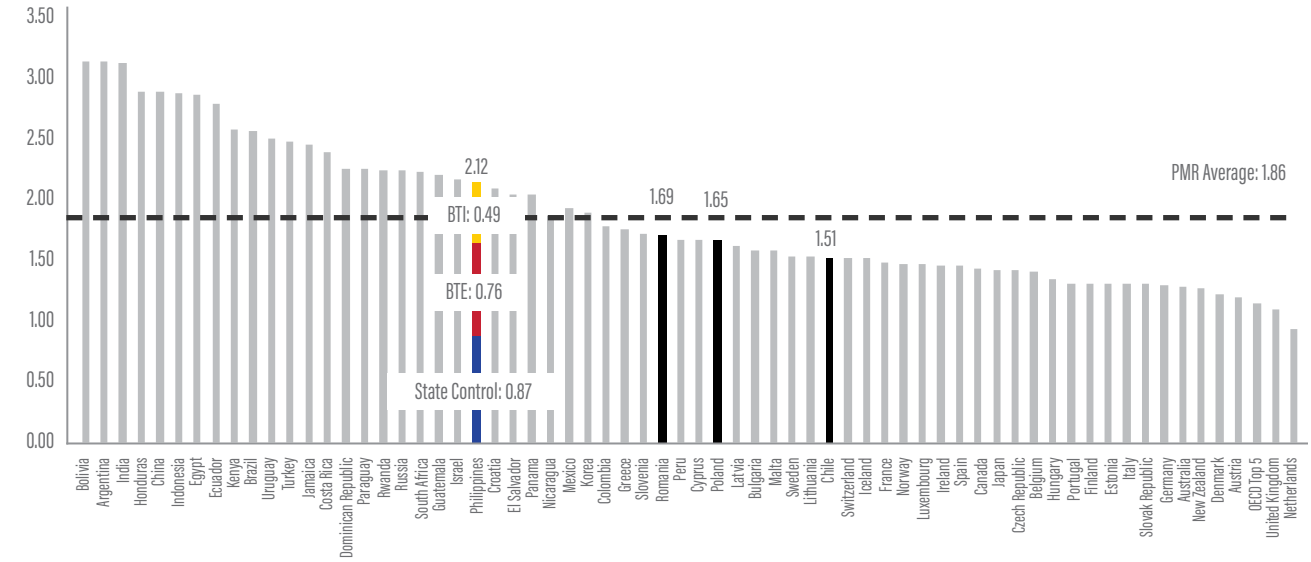
Significant regulatory restrictions play an important role in limiting competition in key sectors of the Philippine economy

In the Philippines, regulatory restrictions might be limiting competition in key sectors of the economy thus affecting the country's ability to maximize its growth potential. Product Market Regulation (PMR) indicators[80] find markets are more restrictive in the Philippines than in comparator countries. While the Philippines' PMR score of 2.12 (out of 6) in 2017 indicates a less restrictive regulatory environment in the Philippines than in some regional peers, including India, China, and Indonesia, it is more restrictive than the average of all countries surveyed (1.86) and other countries in the region such as Korea and Japan (Figure 49). Overall, the three areas of PMR that seem to significantly restrict competition in the Philippines are: 1) public ownership; 2) administrative burdens on start-ups; and 3) non-explicit barriers to trade and investment (Figure 50).[81]

80 The PMR indicators assess the extent to which restrictive regulations related to state control, barriers to entrepreneurship or market entry, and barriers to trade and investment promote or inhibit market forces. State control pertains to direct government involvement in the market through the establishment of SOEs in sectors where private provision is possible and economically viable and/or the implementation of restrictive market and price regulations that may stifle competition. Regulations that create barriers to entrepreneurship are those that raise unnecessary costs which limit market entry and rivalry. These include administrative burdens such as complex license and permit systems coupled with redundant rules and regulations, barriers in services sectors which are key inputs for doing business, legal barriers, antitrust exemptions, and regulations protecting incumbent market players. Lastly, barriers to trade and investment may arise due to explicit prohibitions on foreign participation and investment in certain sectors such as utilities, retail, and regulated professional services. These restrictions can affect the capacity of key sectors to attract the necessary capital, especially for large infrastructure projects, and may trigger SOE presence in most of these sectors.

81 PMR-based restrictions can be divided between three typologies according to their impact on the ability and incentives of firms to compete: (i) rules that reinforce dominance or limit entry, which include entry barriers to monopolized markets, barriers that hinder market expansion, and legal barriers related to licenses and permits; (ii) rules that are conducive to collusive outcomes or increase costs to compete in the market, which include existing restrictions that may facilitate agreements, price controls, and measures that restrict the type of goods/services or location; and (iii) rules that discriminate and protect vested interests, including interventions that distort the level playing field and provide undue advantages to certain firms.

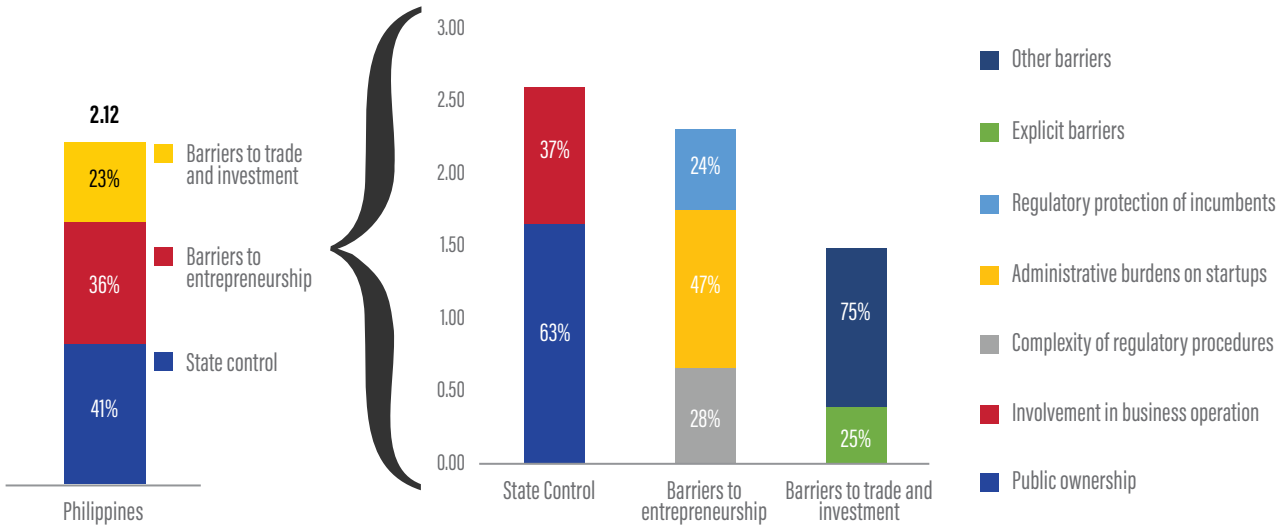
Figure 49.
Economy-Wide PMR Score, 2017 (A higher score indicates greater restrictiveness to competition)



Note: a/ BTI: barriers to trade and investment; BTE: barriers to entrepreneurship. b/ Comparator countries within the PMR database are marked in black.

Source: The Philippines Product Market Regulation (PMR) questionnaire, OECD PMR database, and OECD-World Bank Group PMR database for non-OECD countries.

Figure 50.
Decomposition of PMR Score for the Philippines



Note: The sub-indicator Barriers to Trade and Investment reflects the value of the Organisation for Economic Co-operation and Development's (OECD) Foreign Direct Investment (FDI) Restrictiveness Indicator (https://data.oecd.org/fdi/fdi-restrictiveness.htm#indicator-chart) for all countries with available data when the indicator was calculated. Given that this index was not available for the Philippines, the database uses an average of the FDI index for the other countries for which such Index was available. The qualitative data underlying this sub-indicator reveals significant restrictions to trade and investment.

Source: The Philippines PMR questionnaire.

Box 8.
PMR Methodology: Economy-wide score

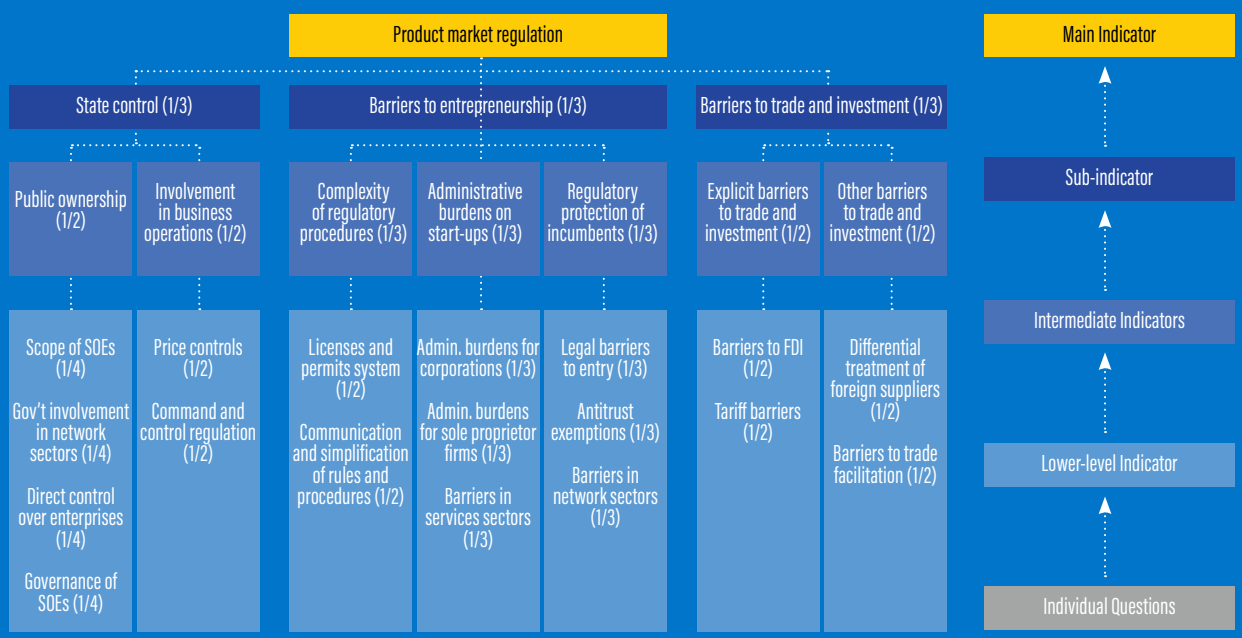
Product Market Regulation (PMR) indicators form a comprehensive and internationally comparable set of indicators that measure the degree to which policies promote or inhibit competition in areas of the product market where competition is viable. PMR indicators are useful to monitor the regulatory achievements of monitored countries and to evaluate the effectiveness of policies introduced over the years. Moreover, they have been widely used to help policymakers create a clear picture of regulations in different countries, with the objective of identifying gaps in regulations and/or room for improvements.

The indicators rely on information collected through the OECD's regulatory indicators questionnaires. Figure 51 summarizes how the economy-wide score is calculated (number in parentheses represent weights). First, the answers are coded into objective information (scores range from 0 to 6, with 6 being the worst). Second, scores of individual regulations are aggregated into subsequently broader regulatory areas from "Lower-level indicators" (18 areas) to "Intermediate indicators" (7 areas), and finally the three "Sub-indicator". The three sub-indicators are averaged to calculate the overall PMR score.

Initially built by the OECD for their members and the OECD plus countries (47 countries total), in partnership with the WBG, the dataset has since been extended to 20 additional countries, including the Philippines.

The PMR indicators are designed to reflect regulations that have the potential to restrict competition in areas where competition is viable. They have a number of features which make them useful not only for analysis, but, more importantly, for policy advice, since they allow to pinpoint specific policies that hamper competition. The PMR indicators are focused on enacted policies and not on outcomes, implying that they are 'objective', in that they are not based on opinion surveys. Finally, PMR indicators focus on regulatory measures that affect the economy at large and can therefore be considered as comprehensive measures of regulatory restrictiveness. PMR indicators are not designed to capture informal regulatory practices nor the effective enforcement of regulations, since they are only concerned with formal compliance with a number of criteria.

Figure 51.
Economy-wide PMR Methodology



Source: OECD 2013 Schemata and Koske et al. (2015)

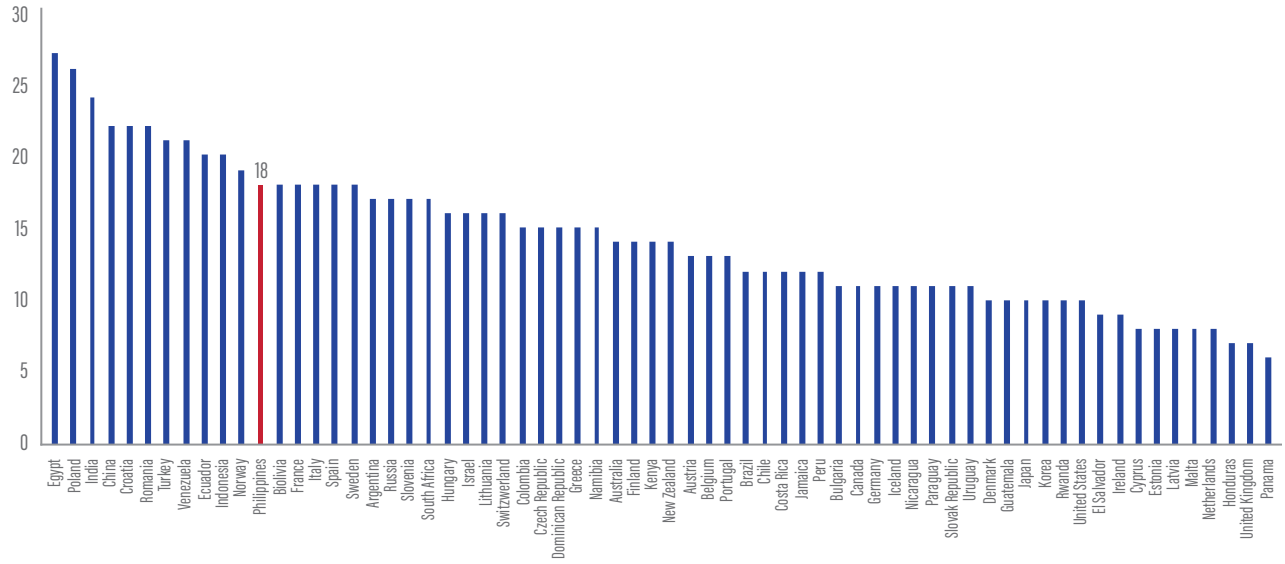
State involvement in business operations and public ownership is significant and hinders private-sector participation

Although the Government of the Philippines has adopted key reforms to rationalize state participation in the economy, SOEs are still present in a number of non-infrastructure sectors where private participation is typically possible and economically viable. Of 27 sectors included in the PMR study, SOEs are present in 18 in the Philippines,[82] while the average of all countries surveyed is 14 (Figure 52). Although the presence of SOEs in infrastructure sectors is not unusual across countries, especially in sectors that require capital-intensive investments such as electricity transmission and road infrastructure, the Government of the Philippines controls at least one firm in 11 out of the 17 non-infrastructure sectors surveyed. These include insurance, financial services, construction, fabricated metal products, wholesale and retail trade, and human health activities, as well as restaurants and hotels. While these SOEs may be relatively small in terms of their market share, their presence questions the subsidiary role of the state, i.e. as provider of those goods and services that the private sector cannot provide by itself. In addition, restrictions on FDI in most sectors with SOEs further exacerbate the effects of state participation.

In addition, the lack of a regulatory framework to control state support measures may result in market distortions, favoring SOEs or specific private firms over private competitors. Statistics from the 2012 CPBI show that fifty-six product markets across sectors, including manufacturing, agriculture, wholesale/retail, and transport/storage, reported at least one firm receiving a subsidy, which is equivalent to 9 percent of all markets in those sectors. However, in many cases, subsidies do not appear to have been granted equally to all firms within the market. In twenty-two industries, only one firm received subsidies when more than one firm operated in the market.

82 According to the PMR questionnaire, an SOE is defined as a company in which state or provincial governments (not including local governments or municipalities) hold, either directly or indirectly through a government-controlled company, the largest single share of the firm's equity capital. Public ownership is measured by the extent to which the government participates and intervenes in markets through the scope and scale of its SOEs. Publicly controlled firms also include government entities that are not organized as companies but operate in business or market activities.

Figure 52.
Number of Subsectors with SOEs by Country



Source: The Philippines PMR questionnaire, OECD PMR database, and OECD-World Bank Group PMR database for non-OECD countries.

Moreover, the existence of undue price controls for certain products may distort the incentives of market operators and affect their ability to compete and provide better quality goods and services.[83] Building on the 1991 Price Act, the Government of the Philippines has enacted broad price controls across sectors. The law enables the Department of Trade and Industry (DTI) to issue guidelines for suggested retail prices covering thirty-one products.[84] Also, recommended prices exist for some regulated professional services such as architects and engineers, and domestic airfares can be fixed by the Civil Aviation Board (CAB).

Meanwhile, important price mechanisms to foster competition through ex ante price regulation are not being applied in network industries. For instance, in telecommunications, the power of the NTC to issue efficiency-based pricing mechanisms in segments where price regulation is typically desirable for competition has been challenged, resulting in a lack of regulation of international wholesale/retail roaming rates.[85] In fact, although

retail prices of international roaming are required to be approved by the NTC, in practice, the regulator does not impose a price ceiling on retail and wholesale access charges.

83 See Nicoletti, Giuseppe and Scarpetta, Stefano, Product Market Reforms: Macro Linkages and Effects on Growth (A Partial Survey), 2004.
84 See DTI *suggested retail prices* at http://www.dti.gov.ph/consumers/e-presyo#price-reports
85 The NTC does not set prices for local loop unbundling.

Barriers to market entry and rivalry in services and network sectors, and excessive burdens to start-up businesses, limit private sector development

High administrative burdens on start-ups make it costly for firms to enter the market. In 2019, the Philippines ranked 166th out of 190 economies on the ease of starting a business in the World Bank's Doing Business report—an improvement of seven places in relation to 2018 (173rd)[86]. According to PMR indicators, the absence of key simplifying tools in the system of licenses and permits, such as the "silence is consent rule," increases the complexity of regulatory procedures.[87] Barriers in service sectors also contribute to the high administrative burden on firms operating in the Philippines. These include entry and behavioral restrictions on regulated services (i.e. accountants, lawyers, architects, and engineers),[88] road freight transport,[89] and retail distribution.

Moreover, incumbent firms are protected by high barriers in network sectors at the expense of new entrants. In telecommunications, unbundling of the local loop is not required (even though it is relevant for broadband access)[90]; entry is franchised to a single firm in the railway sector (there is no vertical separation between the operation of infrastructure and the provision of services in the railway sector)[91]; and there are no legal restrictions to ensure the separation of generating, distributing, and supplying electricity.[92] In addition, legal barriers restricting the number of competitors allowed in the market are pervasive across transport sub-sectors, including road freight,[93] maritime transport,[94] operation of air transport infrastructure,[95] and railways

While the Competition Act applies to all firms across sectors, including SOEs, the potential to grant broad exclusions may be used to favor market incumbents. Laws regulating competition should apply to all sectors and firms engaged in economic activity. The absence of exemptions in the Philippines' Competition Act is key to avoid regulatory insulation of incumbents. However, a forbearance clause that enables the Philippines Competition Commission (PCC) to exempt specific practices or even sectors from the law for a given period of time may pose a risk. While the Act and its implementing rules and regulations establish limitations on the use of the forbearance clause, notably the need to substantiate the granting of exemptions on the basis of economic analysis and their limitation to a one-year term, the mere existence of the clause may increase the risk of anti-competitive behavior and economic distortions.[96] Therefore, the drafting of secondary legislation to clarify the procedures and analytical steps to be followed during its implementation would be key to minimizing potential market distortions.

86 Philippines' 'starting a business' score improved by 3.09 points from 68.88 in 2018 to 71.97 in 2019.

87 The general rule is that a written approval/license must be issued. There is no specific law allowing implicit consent by the administration in case legal deadlines expire.

88 Section 3 will describe the restrictions in professional services in detail.

89 In order to establish a national road freight business, all trucks require a franchise from the Land Transport and Road Franchising Board (more information at http://www.ltfrb.gov.ph/media/Truck_FAQs.pdf).

90 See Broadband Policy Brief Number 4: "Philippine Broadband: A Policy Brief", table 3, p. 10 at http://www.investphilippines.info/arangkada/wp-content/uploads/2016/02/BROADBAND-POLICY-BRIEF-as-printed.pdf

91 In the railway market, ownership and operation are restricted to the government due to Section 1 of Republic Act No. 4156 (year 1964), which was recently extended by fifty years by Republic Act No. 10638 (2014). See http://www.gov.ph/1964/06/20/republic-act-no-4156/ and http://www.gov.ph/2014/06/16/republic-act-no-10638/

92 Meralco is the Philippines' largest distributor of electrical power and engaged in electricity generation and supply. See http://www.meralco.com.ph/about-us/corporate-profile

93 The number of franchises allowed by the government are limited due to road capacity.

94 Port operation is under the authority of the Philippine Ports Authority, as established in Presidential Decree No. 505 of year 1994 (amended by Presidential Decree No. 857, year 1975). See http://www.lawphil.net/statutes/presdecs/pd1974/pd_505_1974.html

95 For example, the Manila International Airport Authority oversees the operation of air transport and infrastructure of Manila Airport, as established by Executive Order No 778 (year 1982).

96 OECD, Competition Assessment Toolkit, Version 2.0, Volume I: Principles, p. 65.

Broad limitations on foreign participation in key sectors of the economy, including utilities and regulated services, thwart trade and investment

Barriers to FDI due to constitutional and legislative limitations on foreign participation in key sectors and economic activities limit competition and could raise input costs for Philippine firms. Entry to all four regulated professions reviewed in the PMR questionnaire—accountants, architects, engineers, and lawyers—is restricted for non-Filipino nationals (Figure 53). The Philippines Foreign Investment Act also limits foreign investment in several industries typically open to FDI, including utilities, retail, restaurants, and hotels. These restrictions, based on the country's Constitution,[97] have affected the capacity of key sectors to attract necessary capital, especially for large infrastructure projects, and led to the presence of SOEs in many of these sectors, making their development dependent on the government's resources.

Entry restrictions affect competition conditions in professional services. Burdensome accreditation requirements apply across the four regulated professions surveyed in the PMR study. The practice of regulated professions is only allowed to Filipino citizens, except for limited cases prescribed by law (e.g. reciprocity and qualification procedures).[98] All four professional services surveyed by the PMR require licensing by the state or a public authority[99] following a compulsory professional examination.[100] Furthermore, membership of professional associations is required for lawyers, accountants and architects[101]. Meanwhile, advertising is restricted for accountants, architects and engineers in the Philippines. In contrast, the majority of countries in the PMR database do not regulate advertising in the engineering and architecture professions and only regulate (rather than prohibit) advertising in the accounting profession. Lastly, lawyers and accountants are granted a number of exclusive or shared exclusive rights to certain professional tasks above the average of the PMR dataset (Figure 54).

97 See Section 1 of Article XII of the Constitution that informs the prohibition for non-Filipino companies to participate in certain sectors or provide regulated professional services.

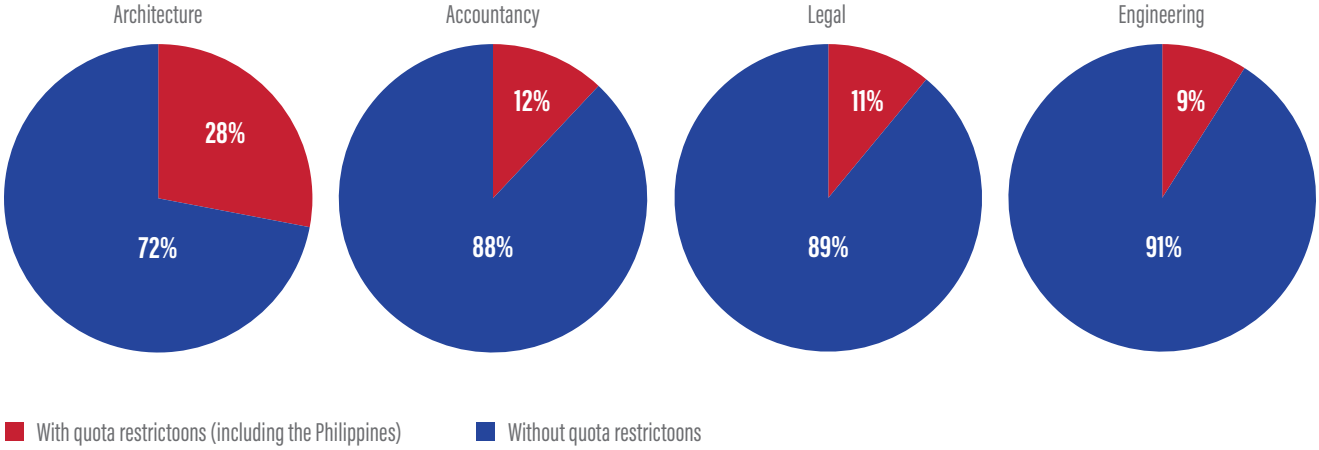
98 Section 14, Article XII, of the 1987 Philippine Constitution.

99 In the accountancy profession, established by Republic Act No. 9294 (Philippine Accountancy Act of 2004); in the legal profession established by Section 5 of the Rule of Court 138 (Attorneys and Admission to Bar); in the engineering profession established by Republic Act No. 544, as amended by Republic Act No. 1582 (Civil Engineering Law); in the architecture profession established by Republic Act No. 9266 (the Architecture Act of 2004).

100 In the accountancy profession, established by the Republic Act No. 9294 (Philippine Accountancy Act of 2004); in the legal profession established by Section 9 of the Rule of Court 138 (Attorneys and Admission to Bar); in the engineering profession established by Republic Act No. 544, as amended by Republic Act No. 1582 (Civil Engineering Law); in the architecture profession established by Section 12 of Republic Act No. 9266 (The Architecture Act of 2004).

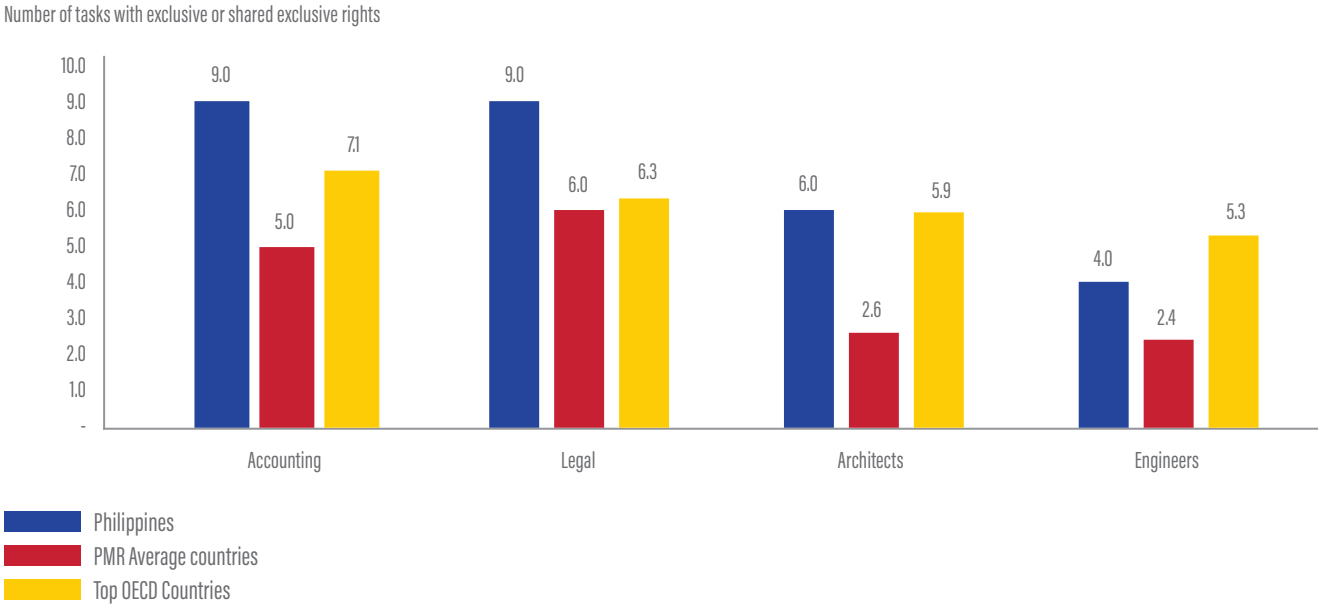
101 In the accountancy profession, established by the Professional Regulatory Commission Resolution No. 106 (July 1984) as amended by Resolution No. 142 (March 1987); in the legal profession established by Section 1 of the Rule of Court 138 (Attorneys and Admission to Bar); in the architecture profession membership to the Professional Regulatory Board of Architecture is required by Section 3 of Republic Act No. 9266 (The Architecture Act of 2004).

Figure 53.
Share of countries with Quota Restriction in Professional Services, OECD and Non-OECD Countries (restrictive countries in blue)



Source: OECD PMR data for OECD countries for 2013 and WBG/OECD PMR data for non-OECD countries 2013-2016.
Note: The Philippines belongs to the share of countries with quota restrictions in professional services.

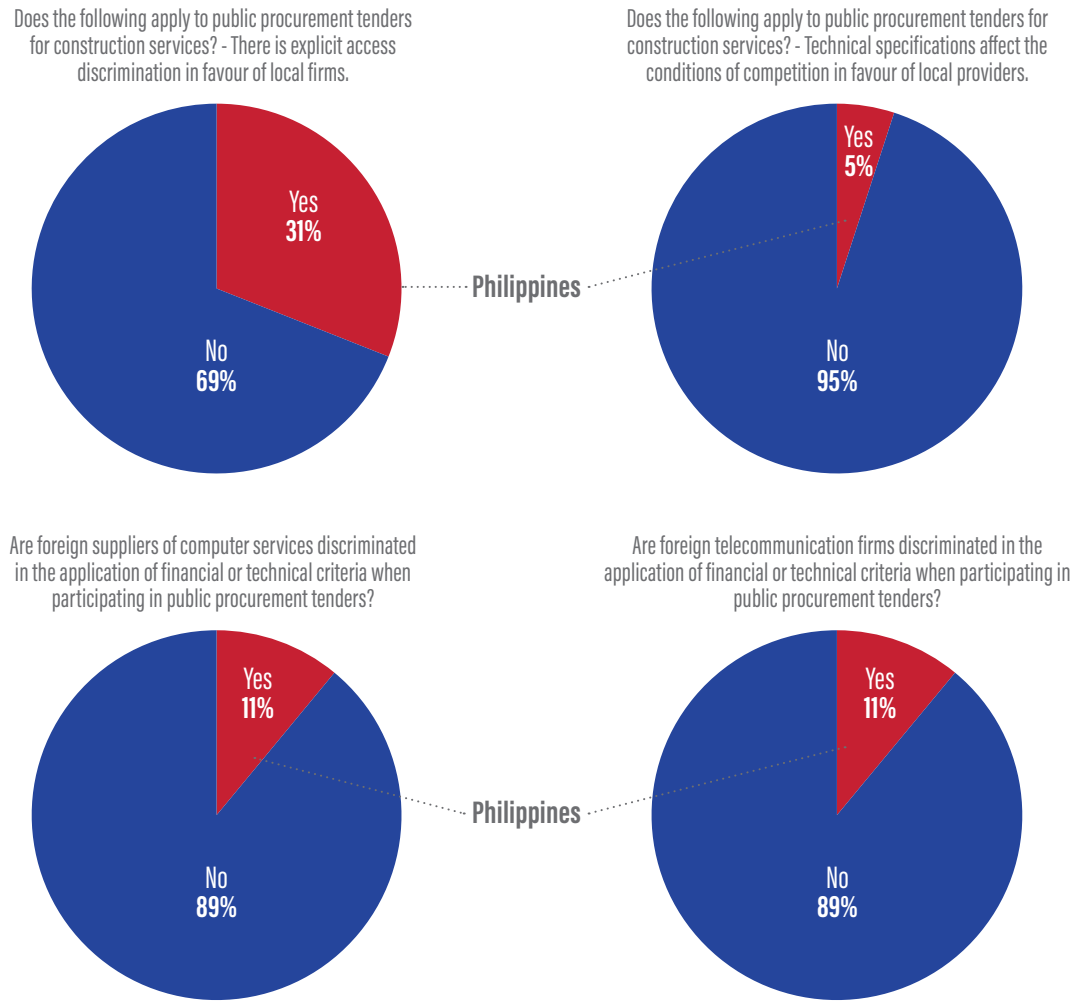
Figure 54.
Philippines lawyers and accountants are granted more than the average number of exclusive or shared exclusive rights



Source: OECD PMR Database 2013, OECD-WBG, PMR indicators 2013-2016. The five main OECD countries regarding sector regulations are: Austria, Australia, Germany, Netherlands and the United Kingdom.

There are also constitutional provisions that lead to the differential treatment of foreign suppliers in public tenders.[102] Allowing national and foreign firms to compete only on the merits—without favoring one over the other—typically has a positive impact on public expenses through lower costs and/or improved quality. Therefore, many countries have implemented reforms that limit the discrimination of foreign participants in public tenders. However, the Philippines' public procurement regulatory framework[103] restricts tenders in public utilities to companies with at least 60 percent national capital. Additionally, in markets where foreign companies are allowed to participate, domestic bidders are given an advantage by the government as they could still win over foreign competitors despite bidding prices up to 15 percent higher than the lowest foreign bid.[104] According to PMR results, these benefits are the exception rather than the rule (Figure 55).

Figure 55.
Share of countries that discriminate against foreign firms in procurement in PMR sample



Source: OECD PMR data for OECD countries for 2013 and WBG/OECD PMR data for non-OECD countries 2013-2016.

Note: The pie charts indicate the shares of countries which answered 'yes' or 'no' to the specified PMR questions. The Philippines belongs to the number of countries which answered 'yes' to the specified PMR questions.

102 See Section 12 of Article XII of the Constitution of the Philippines.

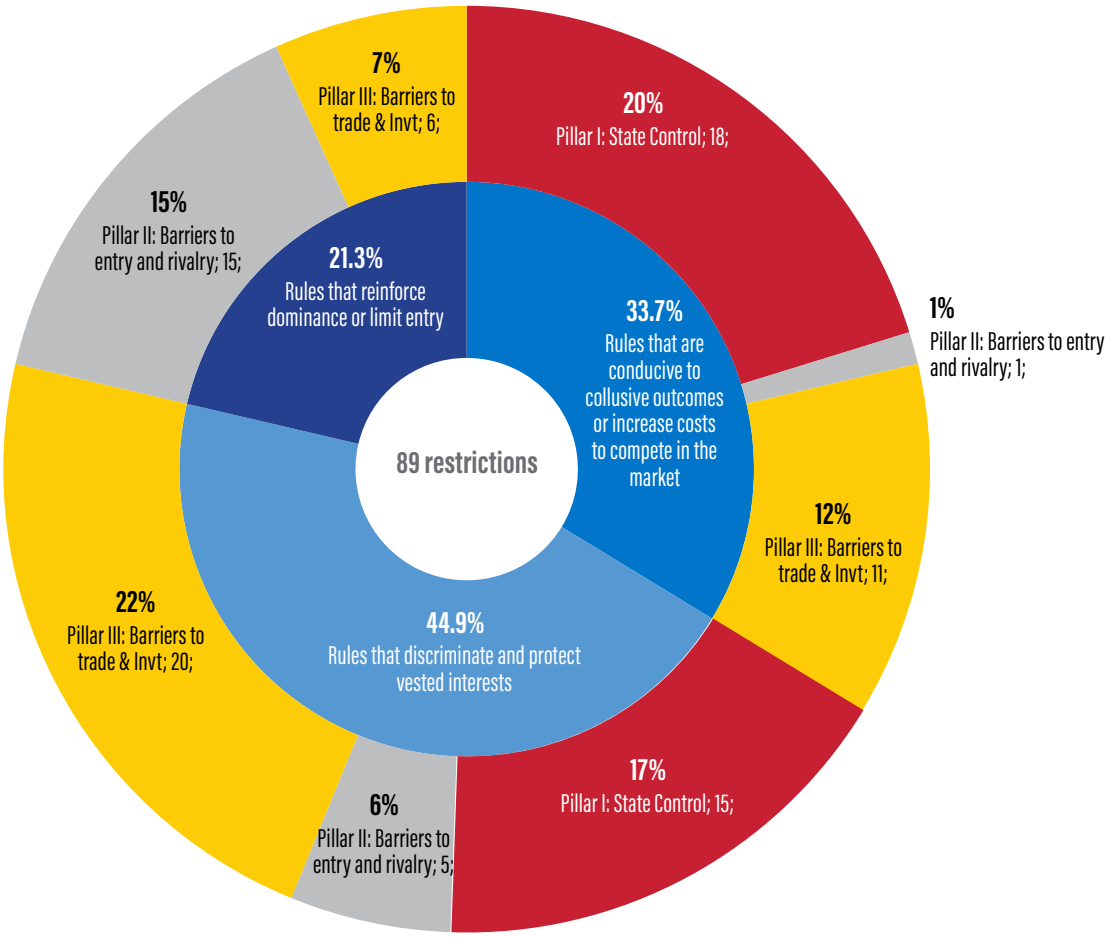
103 See Section 43 of Government Procurement Reform Act (Republic Act No. 9184, year 2002).

104 See The 2016 Revised Implementing Rules and Regulations of the Republic Act No. 9184 at Section 43.1.2.

Removing key regulatory restraints to competition may have a significant impact on the overall economy

Almost half of the restrictions identified in the PMR analysis are related to regulations that discriminate and protect vested interests. 45 percent of the restrictions identified to the PMR study belong to the category of rules that discriminate and protect vested interests, 34 percent are related to rules that are conducive to collusive outcomes or increase the cost to compete in the market, and 21 percent relate to rules that reinforce dominance or limit entry (Figure 56). However, the long list of restrictions needs to be contextualized within the market dynamics of each industry in order to map potential pro-competition reforms according to their impact as well as their feasibility.

Figure 56.
Distribution of Specific Restrictions by The World Bank's Market and Competition Policy Assessment Tool (MCPAT) Category and PMR Pillar Classification



Source: World Bank. Fostering Competition in the Philippines, November 2018.

Note: The inner disc shows that out of the 89 restrictions identified by the PMR, 45 percent of the restrictions belong to the category rules that discriminate and protect vested interests, 34 percent are related to the rules that are conducive to collusive outcomes or increase costs to compete in the market, and 21 percent of the restrictions relate to the rules that reinforce dominance or limit entry. The outer disc depicts how the restrictions are categorized according to the three PMR pillars: state control, barriers to entry and rivalry, and barriers to trade and investment.

Reducing regulatory restrictiveness in key markets would require the implementation of a number of reforms. First, tackling unclear or restrictive regulations in infrastructure sectors and professional services to create more competitive conditions would have positive effects on downstream markets. Second, eliminating restrictions on foreign as well as domestic investors could help level the playing field. Third, minimizing the scope of controlled prices would incentivize firms to compete. Fourth, lessening the involvement of the state through SOEs and other operations in typically competitive markets and ensuring competitive neutrality among public and private operators would promote a more effective use of public funds. Finally, streamlining burdensome administrative procedures for businesses could facilitate easy market entry. Table 8 presents a summary of potential policy options for reducing regulatory restrictions in key markets. The next step in this analysis would be to sequence a package of these reforms according to their impact and feasibility.

Empirical evidence confirms a significant relationship between the degree of regulation in the service sector and growth in productivity and value added. A study of OECD countries based on PMR data shows that lowering the restrictiveness of regulations in the service sector has significant positive effects on value added, productivity, and export growth in service-intensive sectors. A significant reduction in the restrictiveness of regulation across professional services, energy, transport, and telecommunications sectors could lead to an increase of 0.75 percentage points in annual value-added growth in service-intensive sectors.[105]

Removal of PMRs in certain sectors could accelerate economic growth in the Philippines. The removal of restrictive PMRs in the professional services, energy, transport and telecommunications sectors could lead to an additional growth of US$0.6 billion in sectors that use those services intensively, which is equivalent to an increase in the annual GDP growth rate of 0.2 percentage points (Table 7).

Table 7.
Expected Impact of Reforms in Key Sectors on GDP

	Effect of reform on growth in downstream industries with above average service intensity			
Sector for reform	Estimated impact on annual value added[1/]	Expected impact on GDP measured at market prices 2015[2/]		Number of service intensive markets
		(bill. PHP)	(bill. USD)	
Across energy, professional services, transport, and telecommunications[3/]	0.20%	26.8	0.6	91

Note:

1/ Calculations based on the Input-Output (I-O) table 2006, which includes information on 240 specific markets. Impact calculations are the additional value added as percentage of the GDP at current local prices of 2006, generated by improvements in a specific sector.

2/ We assume the structure of the economy remain constant, meaning that the estimated impact of changes in selected sectors on GDP 2006 were the same in 2015. The official exchange rate of 45.5 PHP/USD is used.

3/ Following the results of Barone and Cingano (2011), the estimate assumes a multiplier effect of 0.75pp in downstream sectors which have above average intensity across all named service sectors due to reforms across these selected sectors.

105 A significant decrease in relative regulatory restrictiveness is defined as an improvement of at least two quartiles in the distribution of countries according to their restrictiveness (i.e. a country that moves from the 75th percentile to the 25th percentile in the respective sectoral or lower level indicators). Source: Barone and Cingano (2011)

Table 8.
Summary of Potential Policy Options for Reducing Regulatory Restrictions in Key Markets

	Rules That Reinforce Dominance or Limit Entry	Rules That Are Conducive to Collusive Outcomes or Increase Costs to Compete in the Market	Rules That Discriminate and Protect vested Interests	Responsible Institution
Sector-specific				
Electricity industry			• Regulate the terms and conditions of third-party access (TPA) to the electricity transmission grid, which is currently being negotiated. • Promote regulatory changes that explicitly require at least legal separation between the generation, supply, and distribution of electricity.	Department of Energy, ERC, and PCC
Telecommunications industry	• Require local-loop unbundling (LLU) for telecommunications operators.	• Regulate international wholesale and retail roaming rates.	• Eliminate any discriminatory practice in the application of financial or technical criteria against foreign-owned firms when evaluating public procurement tenders. • Regulate local-loop unbundling prices.	Congress, NTC, and PCC
Rail transport industry	• Adopt a clear policy direction for the PNR on how to improve the quality of services at competitive prices for users by allowing private-sector operators. • Support regulatory changes to prohibit cross-ownership between the management of railroad infrastructure and the provision of railway services (transport of passengers or freight).			Department of Transportation, Regulatory agency, and PCC
Road freight transport industry	• Minimize the power of the regulator to limit industry capacity. • Reform the permits required to operate nationally and sub-nationally so that licenses cover the country's entire road network. • Promote competition in the freight market by allowing foreign firms to participate in the procurement process.		• Improve accountability and transparency when approving new operators by restricting the decision criteria only to technical and financial fitness and compliance with public safety requirements.	Department of Transportation, Regulatory agency, and PCC
Air transport industry	• Support open-sky agreements that include cabotage rights to foreign carriers of signatory countries.	• Liberalize prices of domestic air fares.		Department of Transportation, CAB, and PCC

Table 8.
Summary of Potential Policy Options for Reducing Regulatory Restrictions in Key Markets

	Rules That Reinforce Dominance or Limit Entry	Rules That Are Conducive to Collusive Outcomes or Increase Costs to Compete in the Market	Rules That Discriminate and Protect vested Interests	Responsible Institution
Sector-specific				
Maritime transport industry			• Ensure competitive neutrality between public and private firms in the freight and passenger markets. • Review legislation to separate the PPA's regulatory responsibilities from its development and operations functions to level the playing field and ensure fair competition for investors.	PPA, Department of Transportation, and PCC
Regulated professions		• Support the elimination of advertising and marketing restrictions for regulated professional services (i.e., lawyers, accountants, engineers, and architects). • Improve the ability of regulated professionals to associate/cooperate with each other. • Eliminate price restrictions, in particular for engineers and architects.	• Promote equal treatment of local and foreign suppliers of business services in all four regulated professions by ensuring regulations are enforced under the same principles (not only for those related to public procurement and taxes and subsidies) and by providing the same access to appeal procedures to regulatory decisions. • Allow foreign business professionals to freely practice by minimizing or eliminating any economic needs tests or quotas. • Support the elimination of any ban on foreign business professionals from supplying their services to the government, and any preferential treatment to local suppliers.	Congress, PRC, and PCC
Retail distribution industry		• Minimize limitations on promotions/ discounts that are not predatory pricing practices.		Congress and PCC
Construction services	• Support transparency policies in public procurement for construction services, procurement laws, regulations, and procedures.		• Promote equal treatment among local and foreign firms by removing any access preference (such as technical specifications) given to local firms in public procurement.	Congress, PCAB, and PCC
Public procurement	• Eliminate domestic requirements in public procurement.			Congress and PCC

Table 8.
Summary of Potential Policy Options for Reducing Regulatory Restrictions in Key Markets

	Rules That Reinforce Dominance or Limit Entry	Rules That Are Conducive to Collusive Outcomes or Increase Costs to Compete in the Market	Rules That Discriminate and Protect vested Interests	Responsible Institution
Economy-wide				
Competitive neutrality		• Minimize government intervention (at any level) in the strategic decisions of publicly controlled firms.	• Limit privileges in access to financing for public firms that compete with private operators.	Congress, Governance Commission of GOCC, and PCC
Business regulation	• Streamline burdensome administrative procedures for businesses to facilitate easy market entry.			Congress and the institution in charge of public administrative simplification policies
	• Reduce the administrative burden and unnecessary lengthy procedures by implementing the 'silence is consent' rule.			Congress
FDI	• Eliminate FDI restrictions in key sectors			Congress, DTI, and PCC
Price controls	• Improve market conditions and competition by removing price controls in the retail segment of products such as certain staples (e.g., milk and bread), pharmaceuticals, cellular communication (except international retail roaming), and other products (e.g., books, taxi services, and liquified petroleum gas).			

Source: World Bank Group.

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